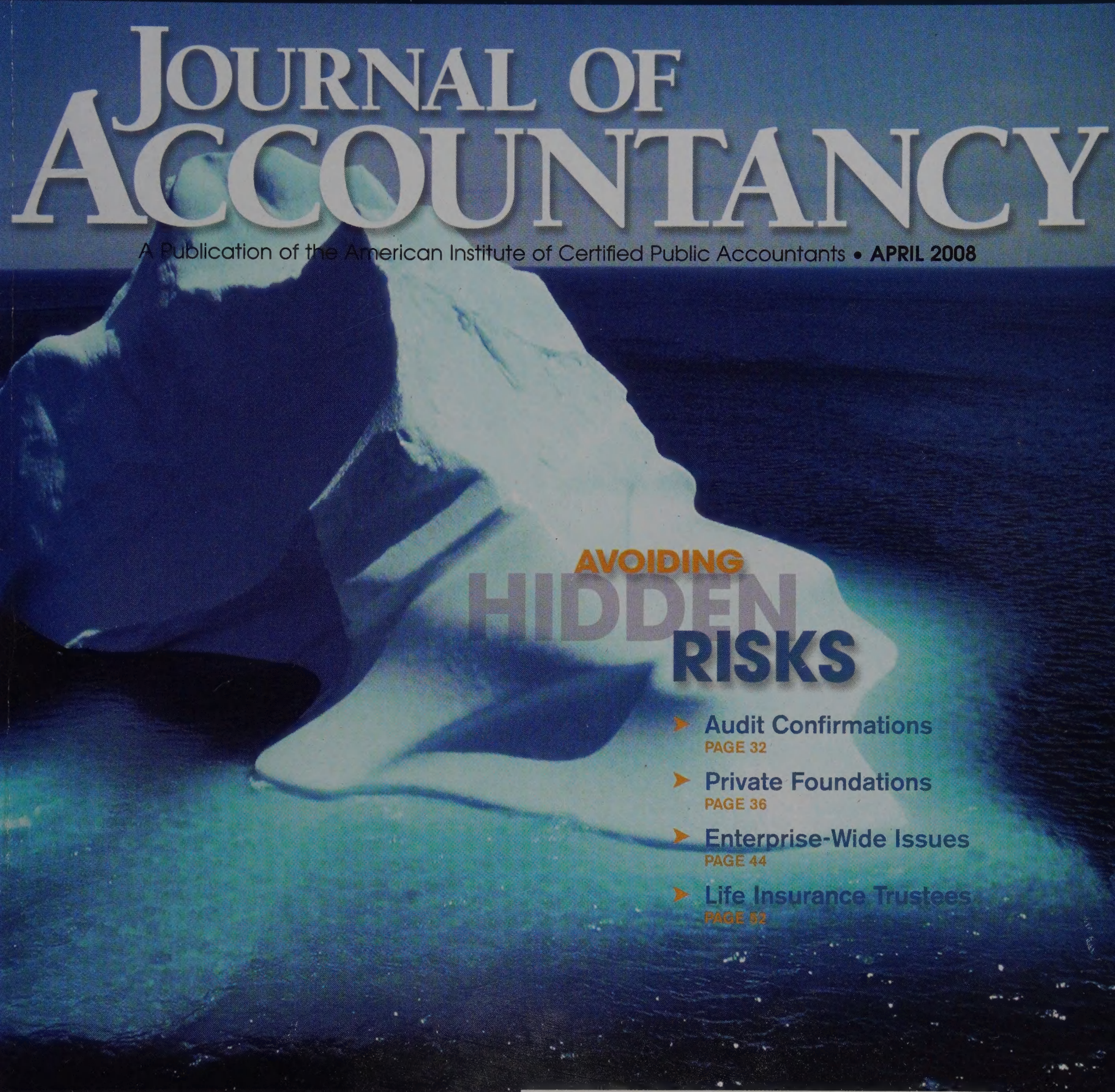
JOURNAL OF ACCOUNTANCY

A Publication of the American Institute of Certified Public Accountants • APRIL 2008



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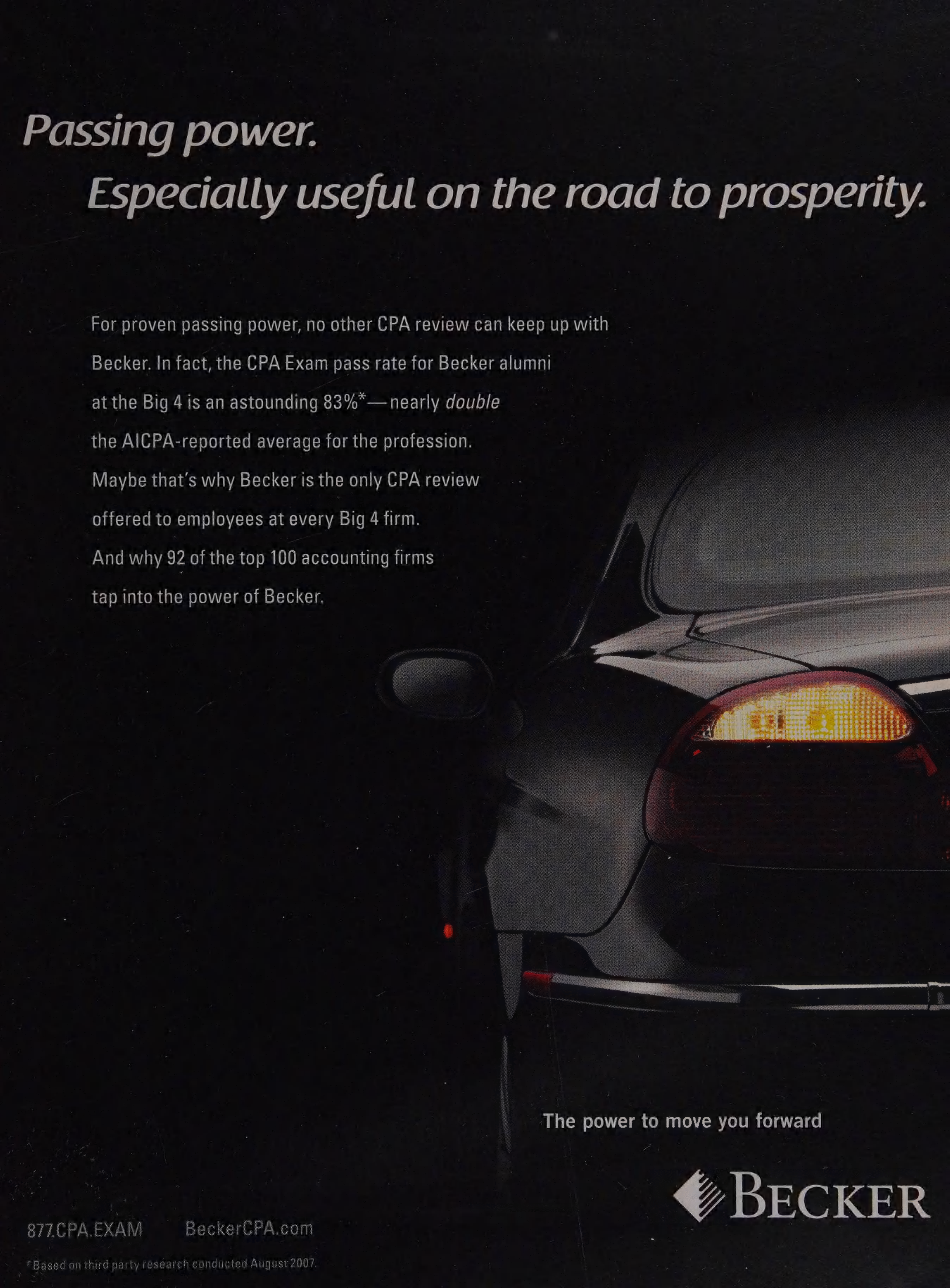
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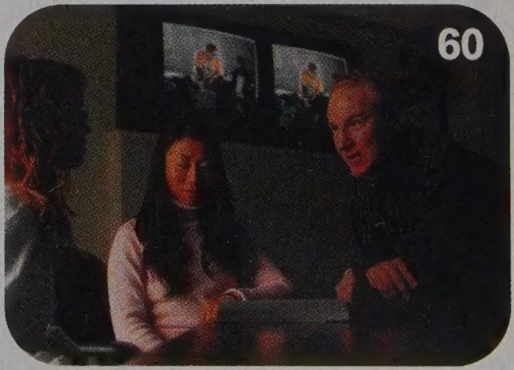

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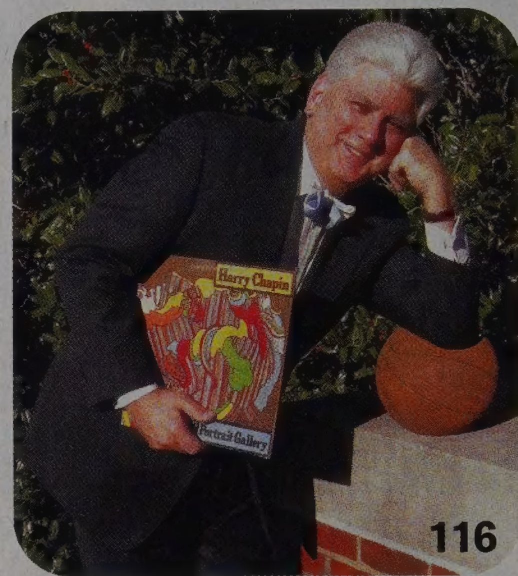

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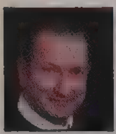

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Mark S. Beasley, CPA, Ph.D., is the Deloitte Professor of Enterprise Risk Management and director of the ERM Initiative at North Carolina State University's College of Management. He is also the American Accounting Association's board representative on COSO.

Bruce C. Branson, Ph.D., is the associate director of N.C. State's ERM Initiative and teaches undergraduate and graduate courses on topics related to financial risk management.

Bonnie V. Hancock is the executive director of N.C. State's ERM Initiative. She joined the faculty at N.C. State in 2006 after serving in several executive positions, including chief accounting officer, at Progress Energy Corporation.

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Don Deans, CPA/PFS, CSA, CFS, received his BSIR and MBA degrees from the University of North Carolina at Chapel Hill. He began work at Haskins & Sells in 1974 and was a partner at Deloitte Haskins Sells from 1985 to 1990. He has worked for the past 12 years in financial services, the last two at Capital Investment Companies, based in Raleigh, N.C.

William B. Nicholson, ChFC, is also a graduate of the University of North Carolina at Chapel Hill and has worked for 15 years at Capital Investment Companies, where he is president of a subsidiary, Capital Insurance Affiliates.

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Jean Marie Caragher is president of Capstone Marketing in Chesapeake, Va., which is celebrating 10 years in 2008. Capstone Marketing provides marketing consulting services to CPA firms including marketing and strategic planning, retreat facilitation, training and marketing director recruiting.

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Linda J. Zucca, CPA, Ph.D., is an associate professor at Kent State University. She is the coordinator for the undergraduate accounting program, the master's of science in accounting program and the internship program. Her research focuses on earnings management and accounting education. She teaches intermediate-level financial accounting courses as well as the orientation class for the Accounting Freshman Interest Group.

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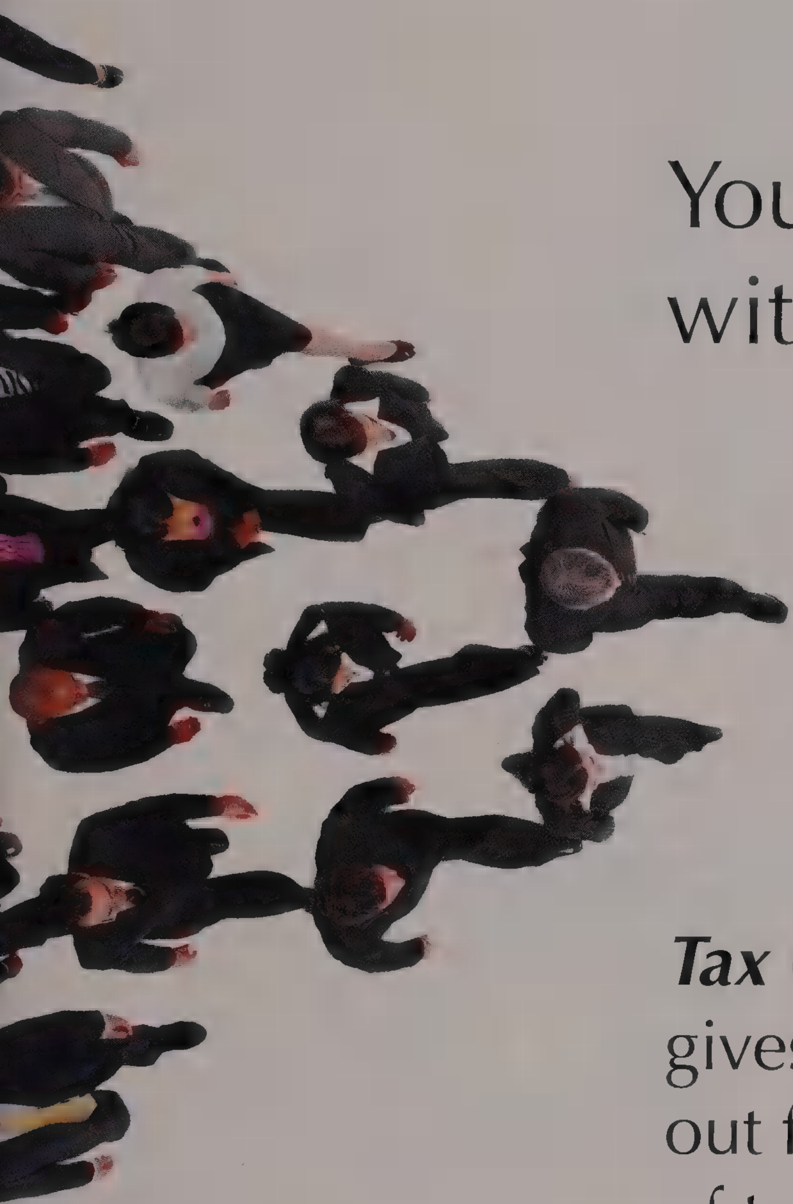
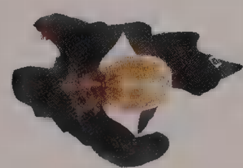

HIGHLIGHTS

The Board of Trustees of the Financial Accounting Foundation (FAF) approved major changes to the oversight, structure and operations of the FAF and its two standard-setting boards, FASB and GASB. The package of changes includes shrinking the FASB board from seven members to five and giving the FASB and GASB chairmen the power to set the agendas and determine the priority of projects taken up by their respective boards.

The changes were recommended by the FAF Trustees' Special Committee on Governance Review, which was established in July 2007 to examine the structure, effectiveness and efficiency of the governance processes of the FAF, FASB and GASB. "We took this action very much with an eye to convergence," Robert Denham, the FAF's chairman, said during a press conference.

Specifically, the FAF trustees voted to:

- Expand the number and breadth of investors, accounting, business, financial and government organizations and entities invited to nominate FAF trustees.
- Increase the governance activities of FAF trustees, including their level of formal review and oversight of data and materials regularly provided by FASB, the Financial Accounting Standards Advisory Council, GASB and the Governmental Accounting Standards Advisory Council.
- Change the term of FAF trustees from one three-year term with a possible second three-year term to one five-year term.
- Change the size of the FAF board from 16 trustees to a flexible range of 14 to 18 trustees, with the size to be fixed by board resolution from time to time.
- Reduce the FASB board from seven members to five, effective July 1, 2008, while retaining the board's simple majority voting requirement.
- Affirm the need for investor participation in FASB deliberations by broadening the bylaw requirement that FASB members possess investment experience.
- Secure a stable and permanent funding source for GASB.
- Retain the current size, term length and composition of the GASB board.
- Vest the FASB and GASB chairmen with the authority to set their respective project plans, agendas and priorities of projects.

The SEC released a proposal that would extend for another year the auditor attestation requirement for smaller public companies under section 404(b) of the Sarbanes-Oxley Act of 2002. Under the proposed extension, the section 404(b) requirements would apply to smaller public companies beginning with fiscal years ending on or after Dec. 15, 2009.

The Commission also announced that it has begun a cost/benefit study of the auditor attestation requirement for smaller public companies. The SEC's Office of Economic Analysis will lead the study with assistance from the Office of the Chief Accountant and Division of Corporation Finance, according to an SEC news release.

For a "plain English" guide to help small businesses understand and comply with section 404(a) requirements, visit www.404.gov.

The SEC Advisory Committee on Improvements to Financial Reporting (CIFiR) issued a progress report to the SEC and for public feedback. The report includes three types of findings—developed proposals, conceptual approaches and currently identified future considerations—in areas including complexity, standard setting, audit process and compliance, and delivery of financial information.

Developed proposals are recommendations that CIFiR believes could be implemented by the SEC, its staff or other bodies, as appropriate. Conceptual approaches represent CIFiR's initial views but require additional vetting before being finalized into a developed proposal. Matters for future consideration are areas in which deliberations and research have not yet begun.

Among the committee's developed proposals are:

- FASB should move away from industry-specific guidance to activity-based guidance (for example, from banking as an industry to lending as an activity by any company) and strive to reduce the number of alternative ways available under GAAP to account for the same transaction.
- GAAP should be based on a presumption that "formally promulgated alternative accounting policies should not exist." In any new projects, FASB should not provide additional optionality, unless, in rare circumstances, it can be justified. Any new projects should include the elimination of existing alternative accounting policies in relevant areas as a specific objective of those projects.
- FASB, the SEC or the SEC staff should issue guidance on how to correct an error consistent with six principles, outlined by CIFiR, including that the determination of how to correct a material error should be based on the needs of current investors.
- FASB should set explicit priorities based on consultation with an Agenda Advisory Group, which would include representatives of the SEC and the PCAOB, as well as representatives from the investor, preparer

and auditor communities.

- FASB should conduct post-adoption reviews of significant new standards, generally within one to two years of their effective dates, to ascertain the degree of diversity in practice in using judgment when applying those standards. If that diversity is too broad or otherwise inappropriate, FASB should amend the standard or issue interpretative guidance.

The committee is expected to make final recommendations to the SEC in August. Information about the committee and progress report is available at **www.sec.gov/about/offices/oca/acifr.shtml**.

■ **Cynthia Fornelli, executive director for the Center for Audit Quality, urged the Treasury Department's Advisory Committee on the Auditing Profession to consider several initiatives** aimed at addressing the supply of experienced auditors in the U.S. Among Fornelli's recommendations was consideration of an increase in the number of H1-B visas, which allow foreign professionals in "specialty occupations" to be employed temporarily in the U.S., to expand the pool of auditors. She also voiced support for consideration of alternatives to traditional classroom instruction to satisfy the 150 semester-hour requirement in certain states for those working to become CPAs.

Fornelli suggested experiential learning, such as practicums or internships within firms, could also help satisfy the 150-hour requirement. She called on the committee to consider a regulatory process for audit firms to remediate independence breaches that would be immaterial to reasonable investors and to reconsider the definition of "audit client" and "affiliate" to clearly target relationships that could cause a conflict for auditors.

Written comments Fornelli and others submitted to the committee are available at **www.treas.gov/offices/domestic-finance/acap/submissions-02042008.shtml**.

■ **Seventeen international accounting firm networks have become the first full members of the Forum of Firms.** These international networks, whose member firms perform transnational audits, have reported that they have implemented a globally coordinated quality assurance program, committed to the use of International Standards on Auditing (ISAs) and met other quality and ethics requirements, according to a Jan. 22 Forum of Firms announcement.

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The Forum of Firms' stated goal is to promote consistent and high-quality standards of financial reporting and auditing practices worldwide. It conducts its business through its executive arm, the Transnational Auditors Committee, which is also a committee of the International Federation of Accountants.

The networks composing the group of first full members originally joined as provisional members. The Forum's current provisional members are working toward becoming full members this year.

Membership in the Forum is open to networks and firms of all sizes that have transnational audit engagements or are interested in accepting such engagements and agree to meet membership requirements. For more information, visit **www.ifac.org/Forum_of_Firms**.

■ **The National Credit Union Administration (NCUA) is seeking comment on whether it should issue regulations to govern the merger of a federally insured credit union (FICU)** into, or a FICU's conversion to, a financial institution other than a mutual savings bank (MSB). The NCUA has no regulations governing these types of transactions.

The NCUA is also considering amendments to regulations regarding mergers, charter conversions and changes in account insurance to address the effects these transactions may have on member rights and ownership interests. Comments are due by March 31.

The Advance Notice of Proposed Rulemaking is available at **www.ncua.gov/RegulationsOpinionsLaws/proposed_regs/P-708ANPR.pdf**.

■ **Domestic and foreign banks tightened lending standards and terms on a broad range of loans in the last three months of 2007, according to the Federal Reserve's** *January 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices*. The survey also reported weakening demand for bank loans by businesses and households.

About 40% of domestic banks and 85% of foreign banks—both a higher net fraction than in the October survey—increased the spreads of loan rates over the cost of funds. Tighter lending standards for commercial real estate were reported by 80% of domestic banks and 55% of foreign banks, both large increases from the previous survey. Between 75% and 85% of domestic and foreign banks expect a deterioration in the quality of the C&I (commercial and industrial) and commercial real estate portfolios. More than 85% of respondents said they would review residential mortgages for modification on a loan-by-loan basis as a "somewhat significant" part of an overall loss-mitigation strategy.

The survey is available at **www.federalreserve.gov/boarddocs/SnLoanSurvey/200801/fullreport.pdf**.

■ **The SEC is taking steps to expedite the distribution of more than $5 billion in SEC recoveries to injured investors.** Richard J. D'Anna has been appointed to lead the newly created Office of Collections and Distributions. Most recently, he was senior vice president at 1st BridgeHouse Securities and a senior vice president and consultant at FITS Inc.

Lynn M. Powalski will become the office's deputy director. Powalski has worked in the SEC's Division of Enforcement since 2001, as both an assistant director and assistant chief litigation counsel for Collections and Distributions.

"The Commission's strong commitment to recovering money from wrongdoers and returning it to investors is amply demonstrated by the more than $2 billion we distributed last year," said SEC Chairman Christopher Cox. "In 2008, we can do more. Dick and Lynn bring exactly the right skill sets to their new positions, and they will make an excellent team to lead the SEC's efforts to get money back to defrauded investors as quickly and efficiently as possible."

■ **Beginning in 2009, employee benefit plans sponsored by charitable organizations and schools under IRC § 403(b) and covered under the Employee Retirement Income Security Act (ERISA) will be subject to the same reporting and audit requirements that currently exist for section 401(k) plans.** Section 403(b) plans are also commonly known as "tax-shelter annuity plans."

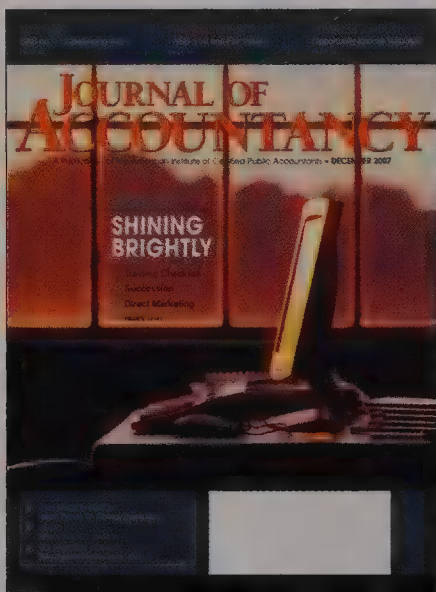
Under new U.S. Department of Labor regulations issued in November 2007 amending the filing requirements for Form 5500, *Annual Return/Report of Employee Benefit Plan,* ERISA-covered 403(b) plans with 100 or more participants generally will be required to file audited financial statements beginning with their 2009 Form 5500 filing. Any 403(b) plans with fewer than 100 participants will be eligible to use abbreviated reporting forms without audited financial statements. The DOL estimates that approximately 7,000 403(b) plans will be subject to the new audit requirements and another 9,000 403(b) plans will be eligible for the waiver.

The DOL regulations were published in the Nov. 16, 2007, *Federal Register* and are available at **www.dol.gov/ebsa/regs/fedreg/final/20071116.pdf**. The AICPA's Employee Benefit Plan Audit Quality Center (EBPAQC), **www.aicpa.org/EBPAQC**, and Expert Panel have formed a joint task force to develop resources to help members with these new audit requirements. ❖

LETTERS

COMMUNICATION IS KEY

Catherine Allen et al.'s article ("Navigating the Crossroads of Control and Independence," Dec. 07, page 42) was an excellent article clarifying the guidance in Statement on Auditing Standards (SAS) no. 112 as it applies to private company auditors' responsibilities of communicating internal control matters. Page 46 of the article provided an example of a client failing to detect an error that the practitioner identified as a significant deficiency in internal control over financial reporting that "would have caused a misstatement in the financial statements."



While the article did not elaborate if the misstatement was material to the financial statements, if a material misstatement would have been reflected in the financial statements due to a deficiency in the internal control over financial reporting (for example, was not detected or prevented by the client's internal controls), it may rise above the level of a significant deficiency and be a material weakness.

SAS no. 112, *Communicating Internal Control Related Matters Identified in an Audit,* states that, "a material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected…"

Additionally, PCAOB Auditing Standard no. 5 states a similar definition for material weaknesses detected during integrated audits for public companies.

The evaluation and assessment of internal control deficiencies is highly dependent on auditor judgment and other engagement-specific factors, in addition to quantitative materiality thresholds. Auditors should apply their own professional judgment when aggregating and concluding on internal control deficiencies.

This article did a good job of providing an overview of the new responsibilities that auditors have when conducting audits of private companies. Communication of these new auditing requirements with clients is a key aspect of the practitioner's job to properly educate their private company clients as to the potential implications of the new internal control communication requirements and the auditor's responsibilities under Generally Accepted Auditing Standards. The new standards can also provide practitioners opportunities to serve their clients as trusted business advisers with regard to their private company clients' internal controls over financial reporting.

Matthew R. Johnson, CPA
Omaha, Neb.

AUDIT PURCHASES TO CHECK REVENUE

I just took your test, "What Is Your Fraud IQ?," (Dec. 07, page 56). I received a score of 90%.

However, I do want to take issue with the wording in one of the questions. In 10(a), you described "Cost of Goods Sold" as an account. Technically, that's not accurate. Cost of goods sold is a subtotal made up of a number of accounts, including the account "purchases." (Although, oftentimes, cost of goods sold is reflected as one number on a published condensed financial statement.)

Therefore, one way to validate fictitious revenues (and also unrecorded revenues) is to audit purchases. This type of so-called "backward auditing" is not only commonly used for the purpose of validating sales, it is commonly used by government agencies for the same purpose, especially with sales tax audits.

Gary M. Barnbaum, CPA
Woodland Hills, Calif.

MINDING ONE'S OWN BUSINESS

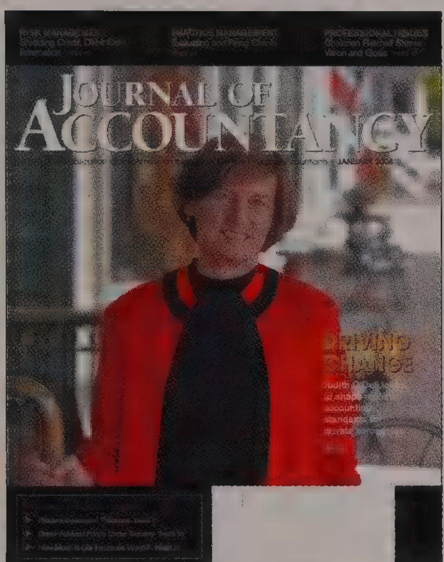
I find it ludicrous that your article, "Software Revenue Recognition on the Rise" (Dec. 07, page 50) not only insinuates but even goes so far as to actually state that companies are changing their business practices because of SOP 97-2. While the accounting profession, of which I am part, is indeed an honorable one, our profession should in no way dictate, or limit, how we, as businessmen, conduct business with our customers.

Chuck Barnewolt
Raleigh, N.C.

Authors' reply: *While we certainly agree that the accounting for a transaction should not drive the related business decision(s), we do believe that it is critical that a company's decision makers are made aware of the accounting consequences involved in sales arrangements. A clear precursor to being able to provide useful and accurate guidance to a company's decision makers is an understanding of the facts and circumstances involved in a given transaction or product offering. Once this information has been gathered and the applicable accounting treatment has been derived, an accountant can then provide a company's decision makers with the tools to understand which direction is most beneficial for their particular entity. Similar to profit*

margin analyses, cash flow analyses, and various other financial metrics, it is reasonable to expect an assessment of the timing of revenue recognition, as well as the cost of compliance, to be considered as part of the set of factors a decision maker considers. Armed with this insight, a decision maker can be comfortable in knowing that they have the full picture associated with an arrangement or type of arrangements, and have been empowered to pursue the best course of action.

Greg Regan, CPA,
and Tim Regan, CPA
San Francisco



FOUND: CLIENT EVALUATION TEMPLATE

The article, "Letting Go: Evaluating and Firing Clients" (Jan. 08, page 54), was well written and exactly on point for my firm.

I am the sole owner of a two-office, 23-person firm. In late 2006, my business partner unexpectedly passed away. During 2007 we had some expected—and some unexpected—changes in our client base. My overall goal for 2007 was to stabilize our client base and make sure we had no net fee revenue loss.

For 2008, my overall goal is to put an annual client evaluation and firing process in place. It would also include formalizing new client acceptance standards and processes.

Is the PCPS template for client evaluation mentioned in the article available?

David B. Tenney, CPA
Marietta, Ohio

Editor's note: *The PCPS Client Evaluation template is available at* ***www.aicpa.org/PUBS/JOFA/jan2008/downloads/Client_Evaluation_v2.pdf****.*

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E-mail: JOAED@aicpa.org
Fax: 919-419-5241
Mail: Letters to the Editor, Journal of Accountancy, AICPA, 220 Leigh Farm Road, Durham, NC 27707-8110.

topline

News, People, Trends and Other Noteworthy Items

TAX NOTES

IRS Targets High-Income Taxpayers, S Corps

One out of 11 individuals with an income of $1 million or more faced an audit in fiscal year 2007, when the number of audits for these high-income taxpayers increased 84%, from 17,015 in 2006 to 31,382.

Overall, audits of individual returns rose by 7%, from 1,293,681 in 2006 to 1,384,563, the highest number since 1998.

When it comes to business enforcement efforts, the IRS focused on the returns of flow-through entities—S corporations and partnerships. Audits of these businesses increased by 26% and 25%, respectively, from 2006 levels, while audits of large corporations were down slightly.

The Service said that as its enforcement budget remained flat from 2006 to 2007, it could not increase audit activity across the board and therefore addressed areas where there was growth and potential risk.

Source: **www.irs.gov**.

TAX NOTES

Rebates to Relieve Debt

When it comes to tax rebate checks, American consumers may not be so eager to spend, spend, spend.

A CCH and Harris Interactive survey asked 2,020 adults what they would do with a broad-based tax rebate. Their responses were:

- Pay down debt–47%
- Save it–32%
- Spend it–21%

Across all income levels, paying down debt was the most common response. In terms of employment status, only 17% of respondents working full time said they'd spend the rebate, while 29% and 32% of unemployed and retired respondents were likely to spend it.

Source: *CCH Complete Tax* survey, **www.completetax.com**.

FINANCIAL REPORTING

Spending on SOX

According to *The Sarbanes-Oxley Investment: A Section 404 Cost Study for Smaller Public Companies*, a study by SOX research and consulting firm Lord & Benoit, the total average combined costs of complying with section 404(a) and section 404(b) was $78,457. The costs ranged from as little as $23,000 for a small software company to as much as $197,000 for a manufacturer/distributor with many locations.

The average costs of complying with a section 404(a) management assessment for all non-accelerated filers included in the study were $53,724 (ranging from as low as $15,000 to as high as $162,000).

In general, the study found that manufacturing and distribution companies incurred higher internal control compliance costs. These companies' robust purchasing, multiple subsidiaries, inventory controls, complex IT systems and large capital expenditures contributed to higher costs.

The average projected costs of complying with section 404(b) for non-accelerated filers included in the study were $24,750. The range of audit fee increases was from as low as $7,500 to as high as $86,000.

Because the standard was not yet effective, the study authors derived the audit fee increases related to section 404(a) by taking the actual 2006 audit fee of each company times the projected audit fee increase that was obtained from *The Audit Analytics 2006 Audit Fee Briefing Paper*, a study by Audit Analytics, that indicated audit fees for smaller accelerated filers increased by 27% from section 404(b).

To download a complimentary copy of the report, visit **www.section404.org**.

Source: The Lord & Benoit Report, *The Sarbanes-Oxley Investment: A Section 404 Cost Study for Smaller Public Companies.*

DATA POINT

87

The proportion of multinational enterprises that believe transfer pricing is a risk when managing financial statements, as compliance requirements have increased due to developments in financial reporting.

More than half of the enterprises surveyed have undergone a transfer pricing examination since 2003, with 27% resulting in adjustments by tax authorities.

Source: Ernst & Young's *2007–2008 Global Transfer Pricing Survey*, **www.ey.com**.

TAX NOTES

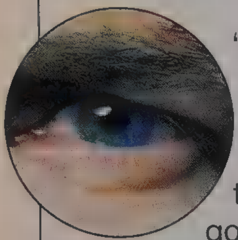
Top Return Errors for Taxpayers and Paid Preparers

Form	Top Error (Number of Errors)
1040EZ Paper Filed	Tax amount wasn't the correct amount based on taxable income and filing status (76,464)
1040EZ E-Filed	EIC was figured or entered incorrectly (136)
1040A Paper Filed	Total exemption amount on page 2 of the return was incorrect (95,666)
1040A E-Filed	EIC was figured or entered incorrectly (516)
1040 Paper Filed	Tax was refigured using computation from Schedule D tax worksheet or qualified dividends and capital gain tax worksheet (198,627)
1040 E-Filed	EIC was figured or entered incorrectly (3,903)

Source: IRS, **www.irs.gov**.

ON THE RECORD

Phoenix Rising



"At the SEC, 2008 will be the year of the Phoenix. That's the name of our updated software system that will track every disgorgement, penalty, and other monies owed to the SEC and to investors…from the beginning of the process until the last dollar is returned to its rightful owner. Ever since the Sarbanes-Oxley Act vastly expanded the SEC's responsibilities in this area over five years ago, the agency has needed such a system. This year, for the first time, we will have it."

–SEC Chairman Christopher Cox, Feb 8.

For more information, see "Highlights," page 15.

Source: **www.sec.gov**.

DATA POINT

$134 million

Cost to produce 8 billion pennies, worth $80 million.

$124 million

Cost to produce 1.3 billion nickles, worth $65 million.

Source: CBS News, **www.cbsnews.com**.

TONE AT THE TOP

Focus on Compliance

On average, compliance spending is outpacing growth of net income at the nation's largest financial and thrift institutions.

A Deloitte Center for Banking Solutions survey found that compliance spending as a percentage of net income rose to 3.69% in 2006 from 2.83% in 2002.

Respondents also recognized that compliance is a customer and reputation issue. Three-quarters said they've noticed a burgeoning link between their compliance abilities and their reputation with customers over the past five years and expect the trend to continue.

Other findings included:

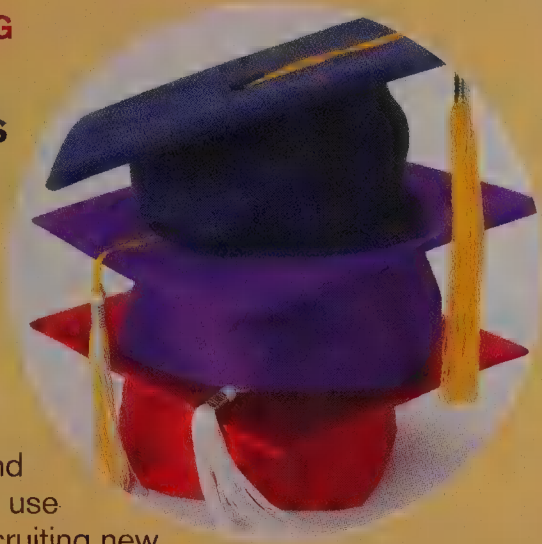
- 60% of individuals with the primary responsibility for compliance reported directly to the CEO.
- 40% said time devoted to compliance has increased by more than 25% since 2002.
- 95% measured compliance performance through internal feedback from testing activities and an internal audit. Other popular methodologies included formal and informal meetings with regulators (90%), industry surveys (80%) and quantitative metrics (55%).

For the study, the Deloitte Center for Banking Solutions surveyed chief compliance officers, chief risk officers and other senior executives at 20 of the top 50 domestic financial and thrift institutions.

Source: *Navigating the Compliance Labyrinth: The Challenge for Banks*, Deloitte & Touche USA LLP, **www.deloitte.com**.

CAREERS & RECRUITING

Signing Bonuses Lure Recent Grads



More entry-level hires may find themselves with deeper pockets in 2008, according to the National Association of Colleges and Employers.

The association's *Job Outlook 2008* survey found 54% of employers plan to use signing bonuses when recruiting new hires, up from 47% in 2007.

Previous NACE studies and surveys suggest that employers often underestimate their need to use signing bonuses. According to Marilyn Mackes, NACE executive director, approximately 47% of employers said they planned to offer bonuses in 2007, but more than 54% actually used them. If the pattern holds, Mackes expects more than 60% of employers could use bonuses when hiring 2008 graduates.

Respondents who planned to offer a bonus to all entry-level hires expected to spend on average $4,450 per bonus—a 25% increase from 2007.

The survey found that two-thirds of employers using bonuses only expect to offer them to select candidates, and the amount of the bonus varies depending on several factors, including degree subject and level.

Source: *Job Outlook 2008*, **www.naceweb.org**.

BUSINESS TRENDS

Benefits Draw Top Talent

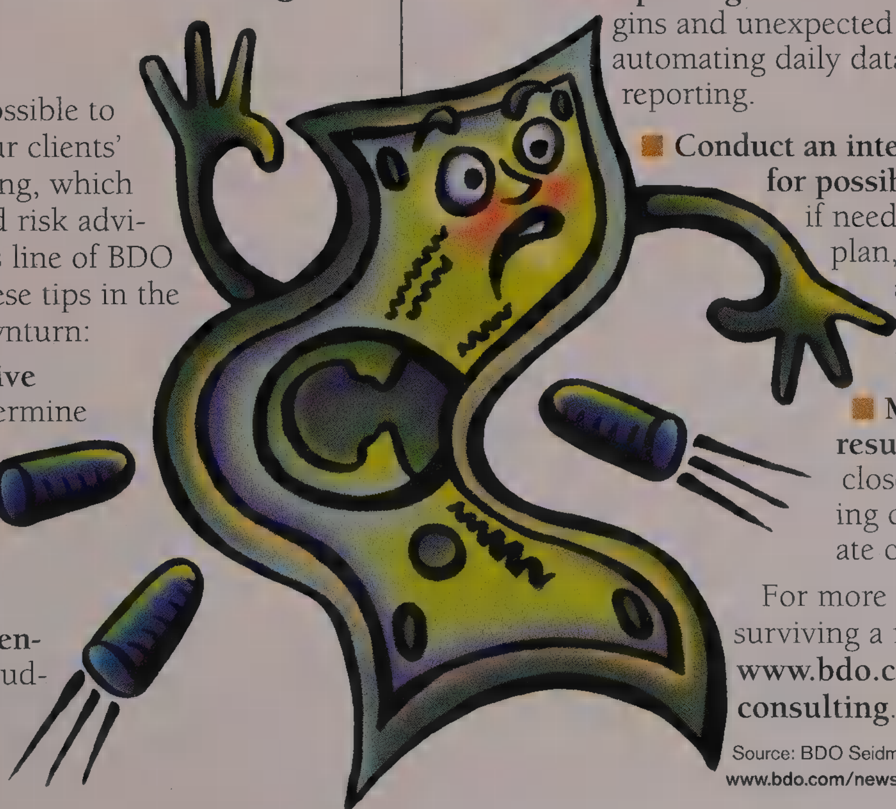
One-third of CFOs surveyed by Robert Half International thought benefits packages were the most effective incentive in attracting top accounting candidates—up from just 2% five years ago.

The findings also suggest that traditional incentives, such as insurance, are a higher priority today than flexible work schedules, which fell as being the most effective incentive among 33% of CFOs in 2003 to 13% in 2008.

Source: Robert Half International, **www.rhi.com**.

BUSINESS TIPS

Weather the Storm During a Recession



While it may be impossible to recession-proof your clients' businesses, BDO Consulting, which provides restructuring and risk advisory services as a business line of BDO Seidman LLP, provides these tips in the event of an economic downturn:

- **Take fast and decisive action**—quickly determine core administrative and operational needs and reduce excess costs.
- **Develop a comprehensive approach**—including a cost-reduction program, plans to improve inventory controls and enhanced purchasing procedures.
- **Manage costs with targeted and timely reporting**—react to falling gross margins and unexpected market changes by automating daily data collection and reporting.
- **Conduct an internal assessment for possible restructuring**—if needed, build a work plan, establish accountabilities and set an implementation timeline.
- **Manage operating results proactively**—closely monitor operating costs and renegotiate contracts.

For more details and tips on surviving a recession, visit **www.bdo.com/services/consulting**.

Source: BDO Seidman LLP, **www.bdo.com/news/pr/722**.

JOURNAL OF ACCOUNTANCY

News Digest

AUDITING

■ The PCAOB voted to adopt Auditing Standard no. 6, *Evaluating Consistency of Financial Statements*, and an accompanying set of amendments to the Board's interim auditing standards.

The new standard and related amendments update the auditor's responsibilities to evaluate and report on the consistency of a company's financial statements and align the auditor's responsibilities with Statement of Financial Accounting Standards no. 154, *Accounting Changes and Error Corrections*. AS6 clarifies that the auditor's report should indicate whether an adjustment to previously issued financial statements results from a change in accounting principle or the correction of a misstatement. The PCAOB also removed the GAAP hierarchy from its interim auditing standards because FASB intends to incorporate the hierarchy into the accounting standards.

The standard (available at **www.pcaobus.org/Rules/Docket_023/PCAOB_Release_No._2008-001_--_Evaluating_Consistency.pdf**) and amendments become effective 60 days after SEC approval.

BANKING

■ The Financial Crimes Enforcement Network (FinCEN) issued an administrative ruling to clarify currency transaction report (CTR) filing requirements for financial institutions when making Bank Secrecy Act reports of transactions involving sole proprietorships and transactions involving sole proprietorships and other legal entities operating under a DBA (doing business as) name.

When filing a CTR involving a sole proprietorship, financial institutions are required to complete only one section A, listing the name of the sole proprietorship's owner, DBA name, the owner's Social Security number, home address, date of birth and occupation. Only one section A needs to be filled out even if the business has a different address or tax identification number than its owner.

The ruling, FIN-2008-R001, replaces ruling FIN-2006-R003. FinCEN said it will continue to accept CTRs with two completed section A's, containing information on both the sole proprietorship and its owner, in accordance with the ruling in FIN-2006-R003.

The ruling is available at **www.fincen.gov**.

■ FinCEN issued interpretive guidance to clarify how rules implementing section 312 of the USA Patriot Act (the correspondent account rule) apply to a covered financial institution presenting a negotiable instrument for payment to another financial institution.

The guidance addresses whether the presentation of a negotiable instrument for payment by a covered financial institution to a foreign financial institution on which the instrument is drawn would establish a correspondent account between the covered financial institution and the paying institution, subjecting the covered financial institution to compliance with the due diligence provisions of the correspondent account rule.

The guidance is available at **www.fincen.gov**.

■ The Federal Reserve Board amended the asset-size exemption threshold for depository institutions that are required to report data under Regulation C, the Home Mortgage Disclosure Act (HMDA). Institutions with assets of $37 million or less as of Dec. 31, 2007, are not required to collect HMDA data in 2008. The previous threshold was $36 million. The amended regulation is available at **www.occ.treas.gov/fr/fedregister/72fr72234.pdf**.

■ The Small Business Administration (SBA) is working to improve its lender oversight practices and maximize lending program efficiency. To protect the agency from potential fraud, SBA's Office of Credit Risk Management (OCRM) checks to ensure that lenders have adequate internal controls to help detect and counter potential fraud. Additional opportunities—such as examining data anomalies, mining third-party databases, random sampling of loans for further review, and identifying and sharing fraud detection best practices—are being explored to identify suspicious lending patterns indicative of fraud.

A lender monitoring and risk management system has been developed with highly predictive lender risk ratings, the agency said. The GAO and SBA's Office of Inspector General have recognized the SBA as conforming to private sector industry best practices for portfolio and risk management.

FINANCIAL REPORTING

■ FASB approved proposed FASB Staff Position no. FIN 48-2, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic*

■ For news from the AICPA and state societies, visit **www.cpa2biz.com**, which also offers online CPE, AICPA professional literature, practice management aids and links to state society Web sites.

Enterprises, which defers the effective date of FIN 48 for qualified entities to the annual financial statements for fiscal years beginning after Dec. 15, 2007, unless they have issued a full set of annual financial statements incorporating the recognition, measurement and disclosure requirements of FIN 48, *Accounting for Uncertainty in Income Taxes*. Nonpublic consolidated entities of public enterprises that apply GAAP are ineligible for the deferral. The FSP is available at **www.fasb.org/pdf/fsp_fin48-2.pdf**.

FRAUD

■ The FBI says the subprime mortgage crisis is feeding a booming business for fraudsters. The Bureau's Subprime Mortgage Industry Fraud Initiative is investigating 14 corporations involved in subprime lending—including mortgage lenders and investment banks that bundle loans into securities sold to investors.

At the end of January, the FBI said it was investigating 1,200 open cases involving subprime lending, a 40% year-over-year increase. Many of these cases involve fraud for profit, where groups of straw buyers or realtors rig schemes to buy properties that are flipped or allowed to go into foreclosure. Suspicious Activity Reports (SARs), which were reviewed for potential mortgage fraud, grew from 3,000 in fiscal 2003 to 48,000 in fiscal 2007. SARs are on pace to top 60,000 in the current fiscal year.

More information and statistics on the FBI's enforcement efforts in this area are available at **www.fbi.gov**.

GOVERNMENT

■ In testimony before the Senate Budget Committee, U.S. Comptroller General David M. Walker said the nation's long-term fiscal outlook is on an "imprudent and unsustainable path." According to Walker, who resigned effective March 12, the U.S. faces an increasing need and a shrinking window of opportunity for action.

"Our long-term fiscal challenge is primarily a health care challenge," he said. "In fact, if there is one thing that could bankrupt America, it's runaway health care costs. We must not allow that to happen."

A GAO report titled *A Call for Stewardship: Enhancing the Federal Government's Ability to Address Key Fiscal and Other 21st Century Challenges* lays out a possible path for change. It provides 13 potential tools for Congress and the administration to use. The report is available at **www.gao.gov/new.items/d0893sp.pdf**.

Walker resigned to become president and CEO of the newly established Peter G. Peterson Foundation. The foundation's stated goal is to enhance the public's understanding of the most "substantial economic, fiscal and other sustainability challenges" the nation faces.

INTERNATIONAL

■ The International Public Sector Accounting Standards Board, an independent standard-setting board within the Interna-

tional Federation of Accountants, issued requirements to help governments and other public sector entities consistently report on international aid, development grants and other forms of external assistance. The disclosure requirements and recommendations are set out in the updated International Public Sector Accounting Standard, *Financial Reporting Under the Cash Basis of Accounting (Cash Basis IPSAS)*. The new disclosures should reduce multiple reporting practices that can be costly for assistance recipients.

The external assistance requirements are effective for reporting periods beginning on or after Jan. 1, 2009. The *Cash Basis IPSAS* is available at **www.ifac.org/store**.

■ The International Auditing and Assurance Standards Board (IAASB) amended International Standards on Review Engagements (ISRE) 2400, *Engagements to Review Financial Statements*, and 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*.

To align the application of ISRE 2400, ISRE 2410 and International Standard on Assurance Engagements (ISAE) 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, the IAASB agreed to restrict the application of ISRE 2400 to a review of any historical financial information performed by a practitioner who is not the entity's auditor.

"These minor amendments, which are effective immediately, clarify the application of the ISREs and ISAE 3000 by eliminating a small gap in the apparent scope of the ISREs and ensuring that, as intended, there is no overlap in the scopes of the ISREs and ISAE 3000," John Kellas, IAASB chairman, said in a press release. "As a result, practitioners will have no doubt about which standard is to be applied to a review engagement."

The amendments to ISREs 2400 and 2410 are available free at **www.ifac.org/store**.

■ The International Financial Reporting Interpretations Committee (IFRIC) released for public comment a draft Interpretation, IFRIC D24, *Customer Contributions*.

Customer contributions are transactions in which an entity—the access provider—receives an asset it uses to provide access to an ongoing supply of goods or services to a customer or customers. In some cases, the access provider receives cash, which it must use to acquire or construct the asset that will provide access.

IFRIC D24 clarifies:

- Whether a customer contribution should be recognized as an asset and, if so, whether it should be initially recognized at cost or fair value.
- Whether an agreement to provide ongoing services using a contributed asset contains a lease.
- How to account for the credit that arises from the recognition of a customer contribution at fair value.
- How to account for a cash contribution.

Comments are due by April 25. To download a copy, visit **www.iasb.org**.

■ The International Accounting Standards Board (IASB) issued an amendment to IFRS 2, *Share-based Payment*. The amendment clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. It also specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The amendment will be effective for annual periods beginning on or after Jan. 1, 2009. Early adoption is permitted. For more information, visit **www.iasb.org**.

■ SEC Chairman Christopher Cox and the European Commissioner for the Internal Market and Services Charlie McCreevy agreed to develop a framework for mutual recognition during a February meeting in Washington. The goals of a mutual recognition arrangement would be to increase transatlantic market efficiency and liquidity while enhancing investor protection, according to an SEC news release. They jointly declared:

"The U.S. and EU, which comprise 70% of the world's capital markets have a common interest in developing a cooperative approach to reducing regulatory friction and increasing investor access to investment diversification opportunities and enhancing investor protections. The concept of mutual recognition offers significant promise as a means of better protecting investors, fostering capital formation and maintaining fair, orderly, and efficient transatlantic securities markets. As we consider implementation of this concept, we encourage input from market participants."

SEC and European Commission officials and staff of the Committee of European Securities Regulators plan to hold regular technical meetings on the mutual recognition framework this year. McCreevy and Cox agreed to work closely during the year to review overall progress, the SEC said.

PROFESSIONAL ISSUES

■ Americans are concerned about retirement savings, health care and educational costs, according to an AICPA survey. Thirty-two percent of respondents from the AICPA Financial Planning Membership Section said their clients are postponing retirement for financial reasons. "Many baby boomers are discovering their retirement kitty is not as big as it needs to be to fund a comfortable retirement and that they are going to have to work longer than they had intended," Jim Metzler, AICPA vice president–Small Firm Interests, said in a news release.

One-third of survey respondents said clients between the ages of 25 and 34 are foregoing buying a home, having children and even saving for retirement. Higher credit card debt due to unnecessary spending is increasing the need for education and guidance to help improve the financial well-being of Americans of all ages, according to Carl George, chairman of the AICPA's National CPA Financial Literacy Commission.

Credit Card Woes

Almost one-third of CPA financial planners said their clients are carrying more credit card debt than they did five years ago. Among them, here's how much more they are carrying on average:

$10,000 or more	35%
$5,000 to $9,999	20%
$2,500 to $4,999	19%
Less than $2,500	2%
Unknown	17%

Source: AICPA *Personal Financial Planning Client Needs Survey*, www.aicpa.org/download/news/2008/AICPA_PFP_Survey.pdf

All Eyes on XBRL

As of September, participants in the SEC's XBRL voluntary filing program had a market capitalization exceeding $2 trillion.

The SEC and IRS have XBRL projects under way for equity regulators and tax administrators, respectively.

Source: XBRL International's *Progress Report—November 2007*, **www.xbrl.org**

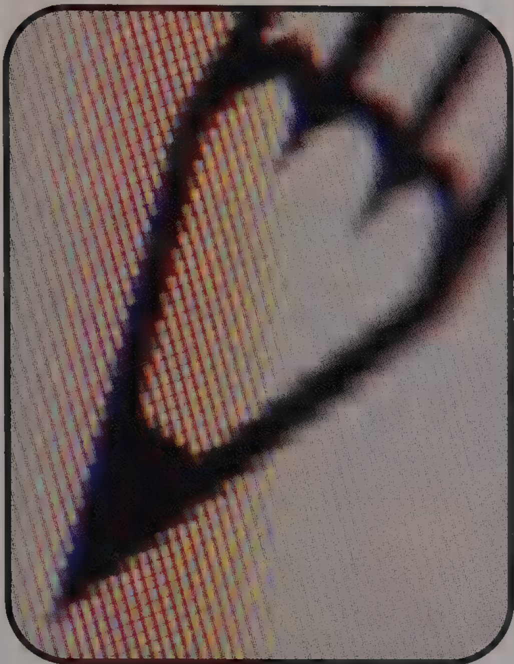
The survey results can be viewed at **www.aicpa.org/download/news/2008/Tabulation_of_AICPA_PFP_Survey_Results.pdf**.

XBRL

■ The SEC's Division of Corporation Finance prepared issuers for the possibility of new proposed rules regarding the use of XBRL as early as this spring.

"As I have said before, we are ready to undertake further rulemaking whenever the technology is ready," said John W. White, SEC director of corporation finance, in a recent speech at the Securities Regulation Institute in San Diego. "That time is fast approaching. In September, the chairman asked for a staff recommendation this spring (which could be a rulemaking proposal), with possible final action coming this fall."

White said the aggressive schedule would allow for a field test of the taxonomies released for comment in December by voluntary filers in their 2008 quarterly filings. "If successful, you can guess where this is all likely to lead," he added. For the full text of White's speech, visit **www.sec.gov/news/speech/2008/spch012308jww.htm**. ❖



CHECKLIST

Fee Management Tips

Properly pricing your services should be a high priority. Follow these best practices for setting and managing fees.

✔ ***Know the costs of providing services.*** Determine direct costs, allocated overhead and targeted firm profits for each client. Divide the fees collected (or collectible) by the time charges to get your realization rate. Determine the overall firm realization rate for all clients by dividing total fees collected by total chargeable time. Review unprofitable clients and consider culling them from your practice (see "Letting Go: Evaluating and Firing Clients," Jan. 08, page 54).

✔ ***Determine the right fee for the value provided.*** Except for specialized work, most service fees can be reasonably estimated. Compare estimates to the value and benefits provided. Specific tax returns priced at $800, when other area accountants charge $500, may not be priced appropriately, likewise for audits priced at $50,000 when other firms charge $30,000. If the time charges are significantly higher than the "right fee," then maybe you should examine your internal processes or efficiencies.

✔ ***Decide on the billing method.*** Tax returns without complications can be priced based upon a fixed fee schedule; or a first-time audit can be based upon time charges (perhaps with a cap). However, assisting a client in selling their business can be based upon a minimum retainer with a bonus for the value added to the transaction.

✔ ***Know the value of the service you are performing.*** Some services carry greater value than others. Firms should understand from the client's perspective the value of the service.

✔ ***Assess your client's ability to pay fees.*** Match service levels to client needs. Don't misdirect extra service efforts toward clients who cannot afford them. Target clients that will benefit from service extras, convey the benefits and show how they can afford to engage you for those services.

✔ ***Bill timely.*** Bill as soon as work is completed. The client is less likely to appreciate the value of a service billed a long time after the work is performed. If possible, ask for a deposit or a retainer in advance. The service is usually more valuable to the client *before* you are engaged than after it is completed.

✔ ***Don't work for clients that don't pay.*** Establish an early understanding that bills must be paid currently. Start a program to help clients catch up on overdue amounts while paying current bills as rendered.

✔ ***Use changes in a client's payment pattern to monitor satisfaction.*** Some clients may express service dissatisfaction by slowing up or holding back payment. Heed payment pattern changes as potential signals. Contact the client to find out what is wrong.

✔ ***Carefully and professionally explain reasons for fee increases.*** Many fee increases are necessary to pass on increased costs. A 5% or 8% increase offsets higher costs. A 20% increase reflects added charges for increased services or extra work for the client. Be proactive, not passive or reactive.

✔ ***Evaluate the threats.*** Fee increases present a threat of losing the client, so be prepared. However, not raising fees also presents a threat to your long-term success and business viability. Fewer clients paying higher fees will receive better service than a larger number of time-consuming clients who pay marginal fees. (See *Bill What You're Worth*, by David W. Cottle, published by the AICPA.)

✔ ***Become your own client.*** Devote time monthly to focus on billing activities: the realization percentages; reviews of the services performed and their value to the client; potential for additional services; and ways to eliminate high-cost, low-realization services.

*—**Edward Mendlowitz**, CPA/PFS/ABV, is a partner in WithumSmith+Brown in New Brunswick, N.J. He has published two practice management books through the AICPA:* Introducing Tax Clients to Additional Services *and* Managing Your Tax Season. *His e-mail address is emendlowitz@withum.com.*

SMART STOPS

On the Web

PRACTICE DEVELOPMENT

MARKETING KNOW-HOW
http://tinyurl.com/2g7bwv
Looking to attract new clients or increase your firm's visibility? Visit this Smart Stop to access the AICPA's "CPA Marketing Tool Kit," part of the Institute's public accounting firm resources. The collection offers customer service and selling tips, client satisfaction surveys, PDF brochures and guidelines for becoming a media resource. The marketing guide includes a sample e-newsletter template, do's and don'ts when creating and marketing a Web site, and e-mail marketing tips.

BE A PROMOTION GURU
www.marketingsherpa.com
Find case studies on what works—and what doesn't—when it comes to marketing your business on this site from MarketingSherpa. The research firm also provides how-to articles and interviews with marketing directors in both business-to-business and consumer marketing. Click the "Browse by Topic/Brand" tab for a complete listing of articles by industry or target, such as "Marketing to Small Businesses" or "Business Services Marketing," or tactic, such as "Integrated Campaigns" or "How to Pitch to Business Media."

MARKET PROFESSIONAL SERVICES
www.legalmarketingblog.com
Don't let "legal" throw you off—this site's client communication and marketing tips can be applied to CPA firms wanting to expand their service offerings or client base. Author Thomas Kane, Esq., the principal of Kane Consulting Inc., has served as an in-house marketer for several firms. Check out articles like "Guarantee Client Referrals With Good Client Relations" and "Narrow Your Niche for More Effective Marketing," or explore the Web's marketing resources using Kane's extensive library of marketing and firm blogs.

GENERAL INTEREST

LINK AND GO
www.taxsites.com
First appearing in this column in October 2004, this index of tax, accounting and payroll specific sites underwent a complete redesign recently. The new site features an expandable navigation tree and improved search capabilities using a Google custom search. There is also quick access to the site's most commonly requested pages—including federal and state tax forms—as well as links to industry associations, certification information and software vendors.

LEAD BY EXAMPLE
www.calcpa.org/forum
Corporate CPAs and financial executives: This leadership forum from the California Society of CPAs and the California CPA Education Foundation is for you. The site provides executive education, advanced training in finance and business management, thought leadership, helpful resources and professional peer networking. The site also features opportunities such as participation in economic forums, CFO of the Year events and local roundtable discussions, which are listed in the "Upcoming Forum Events" section. You can read articles, such as how-tos with practical tips and Q&As with other leaders in the field. There is also a section featuring news on such hot topics as the XBRL taxonomy and new PCAOB standards.

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FEDERAL FOCUS ON TAX
www.treasury.gov/topics/taxes
Use the Department of the Treasury's tax site for access to the latest news and regulatory releases of interest to tax professionals. The site organizes content based on topic, such as tax relief, business tax competitiveness, international tax issues, and health and benefits taxes. CPAs can quickly access information on the earned income tax credit, health savings accounts, and bonds and securities.

—Megan Pinkston

Better Evidence Gathering

Adopting best practices can improve audit confirmation response rates.

by Donald K. McConnell Jr. and Charles H. Schweiger

Well-designed audit confirmation practices provide valuable third-party evidence that sheds light on financial statement assertions made by management. Confirmations can be an effective tool for auditors working with accounts including payables and receivables, inventory, investment securities, lines of credit and other actual or contingent liabilities.

The procedures also can supply audit evidence to help determine whether complex revenue recognition arrangements or related-party transactions are appropriate and corroborate account balances and other information from financial institutions.

Once an auditor has committed to using confirmations, it's important to design testing to trigger high response rates that meet the audit objectives. Many an audit budget has been exhausted by poorly designed confirmation procedures or excessive time spent resolving "discrepancies" that were really the result of attempting to confirm the wrong information.

This article highlights ways to more effectively use audit confirmations and improve confirmation response rates. It also explains some unique, important, or less widely understood aspects of Practice Alert 03-1, *Audit Confirmations*, issued by the AICPA's Professional Issues Task Force.

Improving Response Rates

Accounts receivable confirmation recipients may be more likely to respond and to identify discrepancies if the confirmation request is sent with supporting information, such as a monthly statement. It can be helpful to include with the request a list of outstanding invoices and unapplied credits constituting the balance.

When verifying an account balance is difficult or complex, the auditor can attempt to get confirmation of the supporting information, which would allow the auditor to compute the necessary information. For example, some auditors request confirmation of 401(k) plan deferral percentages elected by employees, rather than requesting confirmation of the actual deferred amounts. Using the confirmed percentages, the auditor can then test the client's calculation of the deferred amount using audited client payroll information.

Sending confirmations to individuals who have been counterparties to key transactions is another way to improve response rates in certain cases. The approach is especially useful for confirming possible side agreements involving rights of return or other significant risks relating to the appropriateness of revenue recognition.

Setting confirmation response deadlines and asking clients to hand sign confirmation requests where feasible can also be helpful. To expedite confirmation responses, auditors can ask clients to make phone calls to intended recipients to alert them that confirmations will be coming. Some auditors will alert recipients of mailed confirmations by sending confirmation request copies via e-mail attachment. The recipient is then asked to return the mailed confirmation either through the mail or by fax.

Faxed responses can pose risks since determining the source of the response can be difficult. For that reason, faxed documents may be considered an option of last resort to be used when deadlines are looming. Auditors relying on a fax should consider making a telephone call to verify the sender's legitimacy and requesting that the original confirmation be mailed. But even mailed confirmations come with some level of risk.

To lessen the risk of fraud, undelivered confirmation requests in most cases would be reported to client officials not directly involved in the area subject to confirmation.

> Sending confirmations to individuals who have been counterparties to key transactions is another way to improve response rates in certain cases.

Issues Involving Positive Confirmation Requests

When positive confirmation requests—those in which the recipient is asked to respond directly to the auditor about whether he or she agrees with information presented in the request—are returned with exceptions, both the qualitative and quantitative nature of the exceptions should be evaluated. The auditor should maintain control over the confirmation process; however, client personnel, under close auditor supervision, can assist in processing confirmation requests and investigating exceptions or nonresponses.

While most accounts receivable confirmation exceptions are related to timing differences, the auditor should, at least on a test basis, inspect evidence supporting the client's reconciliation of differences. If an exception can't be resolved or indicates evidence of a potential misstatement, the auditor can reduce audit risk to an acceptably low level by assessing the nature and cause of the misstatement circumstances.

For example, the auditor can evaluate whether the misstatement appears to be isolated or systemic, and whether it appears to be due to clerical error or possible fraud. If a misstatement appears to be systemic, the auditor would ordinarily need to oversee an extensive investigation.

Additionally, the auditor should project the misstatement from the sample to the population to determine either that the test results support the tested balance or that additional investigation is necessary. Auditors generally send positive requests to confirm large receivable balances because no sampling risk would be acceptable for individual accounts receivable balances exceeding tolerable

EXECUTIVE SUMMARY

- **Confirmations can be an effective tool** when working with accounts payable, accounts receivable, account balances, inventory, investment securities, market values, lines of credit and other actual or contingent liabilities.
- **Auditors are increasingly using electronic means** to confirm cash and loan balances. To rely on an electronic confirmation process, auditors need to be satisfied with the integrity of the process and the effectiveness of the service provider's controls over the process.
- **Sending confirmations to individuals** who have been counterparties to key transactions can improve response rates in certain cases. The approach is especially useful for confirming possible side agreements involving rights of return or other significant risks relating to the appropriateness of revenue recognition.
- **If management requests that** an auditor not confirm certain information and the request is unreasonable and puts significant limitations on audit scope, the auditor ordinarily would disclaim an opinion or withdraw from the engagement. The auditor may also seek the advice of legal counsel.

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Exhibit 1 Audit Confirmations

Circumstances increasing the need for confirming terms of transactions and absence of side agreements:

- Significant sales or sales volume near end of reporting period
- Nonstandard contracts or contractual provisions
- Letters of authorization used in lieu of signed contracts or agreements
- Dates altered on contracts or shipping documents
- "Linked" contracts and transactions
- Lack of evidence of customer acceptance
- Bill-and-hold transactions identified
- Extended payment terms or nonstandard installment receivables
- Lack of involvement of accounting department in sales transactions or in monitoring arrangements with distributors or retailers
- Unusual sales volume with distributors or retailers
- Nonsoftware sales with commitments for future upgrades
- Significant uncertainties or obligations exist in sales
- Sales to financially weak value-added resellers or distributors
- Increasing receivables from a customer, perhaps indicating payments are not due until resale by consignee
- Aggressive accounting practices

Source: Practice Alert 03-1, *Audit Confirmations* (June 2007)

misstatement for the engagement. The amount of any known misstatement identified would be equivalent to likely misstatement because such positive requests constitute a subpopulation that has been audited in its entirety, rather than sampled. Any resulting misstatement in the positive requests would then be combined with any projection of likely misstatement identified from other confirmations that had been selected on a sampling basis.

AU 312.46 states that where the auditor evaluates the amount of likely misstatement from a sample in a class of transactions, account balance or disclosure as material—either individually or in the aggregate with other misstatements—the auditor should request that management examine the class of transactions, account balance or disclosure in order to identify and correct misstatements therein.

Ordinarily, the auditor would report unreconciled misstatements to a client official not directly associated with the account. The auditor needs to consider whether responses indicate matters to be reported to those charged with governance.

Electronic Audit Confirmations

Auditors generally would confirm cash balances unless the risk of material misstatement is low for the cash existence assertion. In some cases, auditors can make an online inquiry about a client's bank balance information—although such a step constitutes an alternative procedure, according to AU 330.04, not a confirmation procedure.

Interpretation no. 1 of AU 330 states that properly controlled electronic confirmations can provide reliable audit evidence. Auditors are increasingly using electronic means to confirm cash and loan balances under the sometimes tight timelines of the audit process. One Big Four firm is conducting a limited electronic confirmation pilot project in the southeastern United States on a concentration of financial institutions that subscribe to a major service provider's electronic confirmation services.

To rely on an electronic confirmation process, auditors need to be satisfied with the integrity of the process. Assurance trust services reports or another auditor's type II SAS 70 report, while not required, can address the operating effectiveness of the service provider's controls over the process.

At least one technology company is providing electronic confirmation services for cash and loan balances by providing an intermediary online link between banks and accounting firms. Bank and client account information is entered via password in a secure, closed system with data encryption.

Management Requests Not to Confirm

Management may occasionally request the auditor not confirm certain balances or other information for seemingly legitimate purposes. For example, customers of a savings and loan may request not to receive monthly statements or related notifications. Another common reason is a disputed balance between a client and the intended recipient.

Such requests from management, however, may be a ruse to divert the auditor's attention from inappropriate transactions. An alleged dispute on its own might not be an appropriate reason for forgoing confirmation. Management representations alone relating to the matter would not provide sufficient appropriate audit evidence.

The impact of such a request on audit risk is an important factor. Assuming the auditor has gathered corroborating evidence about the reasons not to confirm, the auditor should apply alternative procedures, such as examining subsequent cash collection, assuring that payments relate to the receivable balances in question.

Depending on the risk of material misstatement, nature of balances, and availability of audit evidence, the auditor also might examine shipping documents (assuming adequate segregation of duties),

external customer purchase orders, third-party evidence of delivery, sales invoices, contracts or other relevant documentation.

If the auditor is satisfied about having applied alternative procedures, there is no scope limitation and the auditor's report does not need to reference the omission of confirmation procedures or the alternative procedures. Relevant alternative procedures may be omitted if both conditions cited in AU 330.31 exist: (1) the aggregate nonresponding confirmations, projected as being 100% misstated, would not affect the auditor's decision about whether the financial statements are materially misstated, and (2) the auditor has not identified any unusual bias or commonality to exist among the nonrespondents.

The identification of a common thread —for example, that nonresponding customers are in a specific sales territory, are new customers, or are predominantly consignees—might indicate such a bias. Such unusual factors or systemic characteristics may not always be evident.

If management's request that an auditor not confirm certain balances or other information is unreasonable and imposes significant limitations on audit scope, the auditor ordinarily would disclaim an opinion or withdraw from the engagement. The auditor may also seek the advice of legal counsel.

Confirming Terms of Unusual or Complex Agreements

AU 316.41 states that the auditor should ordinarily presume a high risk of material misstatement due to fraud relating to revenue recognition. Revenue recognition risks can reside in bill-and-hold arrangements and improper sales cutoff schemes. Additionally, management may override controls over software sales contracts, as seen in the case of Computer Associates International, when material contracts were backdated to manipulate sales.

"Round-trip" or "linked" transactions can be of concern in industries for which analysts focus more on revenue than on income measures. Round-trip transactions occur when a business or organization records seemingly valid sales transactions with a customer, but returns the sales proceeds to the customer in subsequent purchase transactions, often in a different accounting period.

"Round-trip" or "linked" transactions can be of concern in industries for which analysts focus more on revenue than on income measures.

In addition to confirming balances, the auditor should consider requesting confirmation of the terms of unusual or complex agreements and the absence of side agreements, where there are significant revenue recognition risks. Enron used special-purpose entities (SPEs) to avoid consolidation of debt, impaired assets and losses. Side agreements compensating outside financiers for losses sustained by the SPEs allegedly were not revealed to the auditors. These side agreements often involved the issuance of additional Enron stock, violating the 3% outside equity requirement, in place at the time, for nonconsolidation.

Knowledge of these facts likely would have prompted the auditors to conclude that consolidation was a more appropriate accounting treatment. The auditors might have detected these side agreements by requesting confirmation of their absence. Such confirmations should be addressed to personnel familiar with the terms of transactions, such as the countersignatory, rather than lower-level employees.

"Open" confirmations—those requesting that respondents indicate their understanding of relevant information—may be especially useful for confirming transaction terms. Exhibit 1 lists some circumstances that increase the need for confirming terms of transactions and the absence of side agreements.

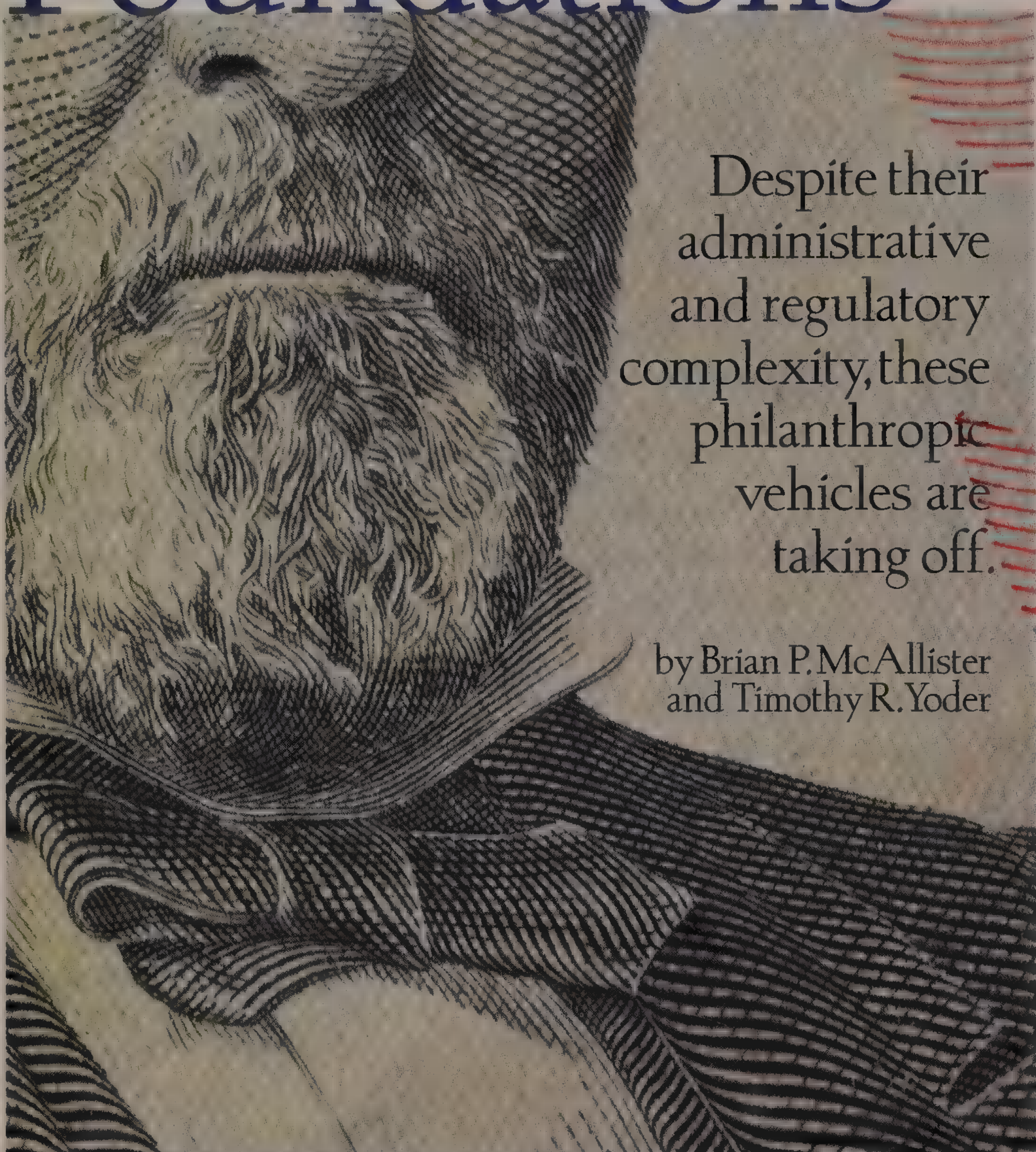
Confirming Accounts Payable and Related-Party Transactions

Many auditors opt to perform a search for unrecorded liabilities, often through the end of fieldwork, as an alternative to confirmation of accounts payable. However, accounts payable confirmations can be effective in detecting round-trip transactions, especially where the "purchase side" of these transactions is not consummated until after the end of the purchasing entity's fieldwork.

Where accounts payable confirmations are used for such purposes, auditors would generally use blank form requests, which ask respondents to provide balances. Also, it may be effective to ask respondents to provide detailed listings of payables balances, as well as information about quid pro quo transactions involving equal exchanges.

Fraud risks also may lurk in related-party transactions and transactions involving variable-interest entities. The auditor should gain an understanding of the business rationale for such transactions and consider confirming the terms with other parties to the transactions. Also, because management may be on both sides of these transactions, auditors may want to seek audit evidence from intermediaries such as banks, guarantors, agents or attorneys. ❖

Advising Private Foundations



Despite their administrative and regulatory complexity, these philanthropic vehicles are taking off.

by Brian P. McAllister and Timothy R. Yoder

In the arsenal of estate planning, private foundations have traditionally ranked among the big guns. With their relative formality and extensive tax rules, they have been considered the province of the truly wealthy—people with $1 million or more to dispose of charitably. The belief that lesser largesse could be better served by donor-advised funds and certain types of supporting organizations (see "The Rich Truly *Are* Different," *JofA,* April 04, page 32) is changing. The Pension Protection Act (PPA) of 2006 has curtailed many of the tax and other advantages enjoyed by those two alternative philanthropic vehicles. Today, small family foundations with assets under $1 million make up nearly 60% of all foundations. One factor driving this growth is the unprecedented transfer of wealth to the post-boomer generation that has begun and is likely to accelerate in coming years. Often, these small foundations are administered by family members, who rarely have expertise regarding the complex tax regulations involved.

For all these reasons, developing a niche practice in private foundations poses growth possibilities for CPA firms, according to Holly M. Pantzer, CPA, a partner with BKD LLP, one of the 10 largest CPA and advisory firms in the U.S., where her areas of expertise include advising private foundations. CPA firms are increasingly likely to be advising founding benefactors of family foundations. CPAs can be a valuable resource for monitoring compliance with the many tax laws unique to private foundations. Awareness of the nuances of private foundation laws is especially important now, given the increased scrutiny of all tax-exempt organizations by Congress and the IRS. Advisers can help prevent inadvertent but costly violations of the tax laws peculiar to private foundations. Key issues for benefactors considering a private foundation include:

- Comparisons to other options (donor-advised fund or supporting organization)
- Prohibitions on self-dealing
- Excise taxes on net investment income
- Taxes on undistributed income
- Taxable expenditures and expenditure responsibility
- Jeopardizing investments and excess business holdings

Private foundations operate exclusively for religious, charitable, scientific or similar activities as described in IRC § 501(c)(3) and are exempt from income tax but commonly pay excise taxes on net investment income and, sometimes,

as penalties. They are usually funded by a single contributor, such as a family or corporation, rather than by the general public, as with a public charity. They may either directly conduct exempt activities (operating foundations) or make grants and distributions consistent with their exempt status (non-operating foundations).

Although private foundations often support other tax-exempt charitable organizations, a private foundation is not what tax law calls a "supporting organization." A supporting organization exclusively benefits, is controlled by, or operates in connection with a public charity. Nonetheless, CPAs should be familiar with the four types of supporting organizations (see Exhibit 1 for resources) when advising private foundations. Grants made to a Type III non-functionally integrated supporting organization require additional administrative and reporting requirements. In addition, grants to this type of supporting organization are not included in qualifying distributions for purposes of meeting the distribution requirements.

Exhibit 1 Resources for Tax Information for Private Foundations

General Information
Council of Foundations, **www.cof.org**
Foundation Center, **www.foundationcenter.org**
Internal Revenue Service, **www.irs.gov**
National Center for Family Philanthropy, **www.ncfp.org**

Supporting Organizations
IRS, **www.irs.gov/charities/article/0,,id=137609,00.html**
Council of Foundations, **www.cof.org/Learn/content.cfm?ItemNumber=5336&navItemNumber=5337**

Donor-Advised Funds
Council of Foundations, **www.cof.org/Action/content.cfm?ItemNumber=5275&navItemNumber=5276**

Self-Dealing
IRS, **www.irs.gov/charities/foundations/article/0,,id=137679,00.html**

Expenditure Responsibility
Sample reporting templates, **www.cof.org/members/content.cfm?ItemNumber=624&navItemNumber=2724**

PRIVATE FOUNDATION VS. DONOR-ADVISED FUND

CPAs should assist funders in determining if a private foundation is the best charitable vehicle for their needs. One alternative to establishing a private foundation is to establish a donor-advised fund with a sponsoring organization. Donors make contributions to sponsoring public charities. These funds are separately accounted for and associated with a named donor. The donor then has a reasonable expectation of being able to advise the sponsoring organization as to the distribution of these funds. The donor's role must be advisory, and the sponsoring organization must exercise full control and variance powers over the donated funds.

The conventional wisdom has been that donor-advised funds may offer lower administrative costs than private foundations; however, this is not necessarily true. A remaining benefit of a donor-advised fund is that, unlike private foundations, they are not subject to excise taxes on net investment income. Since passage of the PPA, however, they are sub-

EXECUTIVE SUMMARY

- **Small family private foundations are growing** at a rate of six per day. This indicates a growing probability that CPA firms will be advising benefactors of family foundations. It is vital that CPA firms understand the complex tax rules related to private foundations.
- **Private foundations are not allowed** to engage in transactions with "disqualified persons," which include foundation managers and substantial contributors, even if the transaction is conducted at fair market value.
- **Excise tax on the net investment income of private foundations** is assessed at 2%. However, the rate is lowered to 1% for years in which the private foundation makes qualified expenditures in excess of the prior five-year rolling average qualified expenditure ratio plus 1% of current-year net investment income.
- **The minimum annual distribution of private foundations** is roughly 5% of the average monthly fair market value of assets. Distributions in excess of this amount may be carried forward for five years to offset future required annual distributions.
- **Private foundations must pay an excise tax** on "taxable expenditures." In general, these expenditures are made for any purpose other than religious, charitable, scientific, literary, educational or other public purposes. To ensure grants made to organizations other than public charities or exempt operating foundations are not classified as taxable expenditures, a private foundation must exercise expenditure responsibility.
- **Private foundations are not allowed to invest** in risky investments, unless the investments are related to the exempt purpose of the foundation. Private foundations are also not allowed to invest in a business enterprise if the combined ownership interest of the private foundation and all disqualified persons exceeds 20% of the business enterprise.

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ject to penalty taxes similar to those on private foundations (see "Donor-Advised Funds: Preparing for Closer Scrutiny," *JofA*, Jan. 08, page 28).

Two major advantages of donor-advised funds survived the PPA, however. First, while deductible cash contributions to donor-advised funds are limited to 50% of a taxpayer's adjusted gross income (AGI), deductible cash contributions to a private foundation are limited to 30% of a taxpayer's AGI. Second, the deduction for long-term capital gain property other than publicly traded securities contributed to a private foundation is limited to the donor's basis in the property, while gifts of similar property to a donor-advised fund is not subject to the same limitation. Depending upon the donor's circumstances and assets, these could be major considerations if a substantial portion of a donor's wealth consists of closely held stock.

It is difficult to establish a contribution threshold at which a private foundation is preferable to a donor-advised fund. The fact that two-thirds of family foundations have less than $1 million in total assets indicates that this threshold is below $1 million for many donors.

> The estimated number of grant-giving foundations increased from 40,100 in 1995 to more than 71,000 in 2005.
>
> Source: Foundation Center, **www.foundationcenter.org.**

Avoid Conflicts of Interest—Taxes on Self-Dealing

CPAs should be aware that private foundations are generally not allowed to engage in transactions with "disqualified persons." Such persons include foundation managers—an officer, director or trustee of the foundation—or substantial contributors. Family members of those persons also may be disqualified. A substantial contributor is one whose cumulative contributions exceed the greater of $5,000 or 2% of the total cumulative contributions received by the foundation from the date of its creation through the end of the tax year. Since the self-dealing rules take effect on the day the person's cumulative contributions become "substantial," it is important for foundations to continually monitor contributions against the threshold. The following transactions with a disqualified person, with certain exceptions, are considered to be "self-dealing acts" subject to potentially high excise taxes under IRC § 4941:

- Sales or exchanges of property
- Leases
- Loans
- Providing goods, services or facilities
- Paying compensation or reimbursing expenses
- Use of income or assets of the foundation by a disqualified person
- Certain payments of money or property to government officials

Excise taxes of 10% and 5% of the amount involved in each act of self-dealing are assessed, respectively, against a disqualified person and, if he or she was aware it was an act of self-dealing, a participating foundation manager. If the transaction is not corrected in a timely manner, additional taxes of 200% and 50% are assessed against the disqualified person and the foundation manager, respectively. Excise taxes are assessed on the "amount involved" in the transaction, which is generally the greater of the fair market value of cash and property either given up or received by the private foundation.

Excise taxes may be imposed even if the self-dealing transaction is at "arm's-length." A disqualified person is allowed to provide property to a private foundation free of charge. However, if a disqualified person provides property for a price to a private foundation, the entire transaction is considered self-dealing.

Disqualified persons are allowed to receive compensation for personal services provided to private foundations if those personal services are reasonable and necessary. An excise tax may be assessed, however, on any compensation or expense reimbursement deemed excessive. Moreover, not all services provided by a person are necessarily considered personal services within the meaning of the exception. Therefore, a foundation should document the job duties and workload of the disqualified person as well as compensation paid to persons with similar duties and workloads at similar foundations. According to Pantzer of BKD LLP, this is particularly important at small family foundations where second- and third-generation family members are being compensated.

The tax laws and regulations applicable to private foundations cannot be navigated by a reasonableness standard. The laws were written to be restrictive and completely eradicate certain practices of wealthy donors. It is often not relevant if a transaction benefits the foundation at the expense of a disqualified person. Almost always, a transaction between a private foundation and a disqualified person will be considered self-dealing. See IRC § 4941 and sources in Exhibit 1 for examples.

Minimize the Tax Crunch—Tax on Net Investment Income

CPAs can help private foundations minimize taxes by understanding the dual rate structure of the excise tax on net investment income. Net investment income of private foundations is generally taxed at 2%. However, the rate is reduced to 1% if qualifying distributions exceed current-year average monthly FMV of investments, plus or minus certain adjustments, multiplied by the average distribution ratio for the prior five years, plus 1% of current-year net investment income. Net investment income is gross investment income, including capital gains, less ordinary and necessary expenses incurred in the production of the investment income.

Halving your client's tax liability is always a worthy goal, but at least two

factors can make it difficult to apply the formula. First, if the foundation's portfolio includes mutual funds, the foundation has little control over timing of realized capital gains and losses, which can make income more difficult to predict. Second, all else being equal, the formula requires a slow but steady year-to-year increase in giving to qualify for the reduced tax on net investment income. This may deter a foundation from making a significantly higher payout in years when special philanthropic needs are especially high.

> One-third of all family foundations have less than $250,000 in assets, and nearly two-thirds have less than $1 million. Overall, small family foundations are growing at a rate of about six per day.
>
> Source: *Baltimore Sun*, Feb. 23, 2007.

SPEND IT—TAXES ON UNDISTRIBUTED INCOME

Private foundations are required to pay out their "required distributable amount" each year or pay a 30% excise tax on whatever portion of it has not been distributed within a year. Any portion undistributed after two years is subject to an additional 100% tax. If a foundation distributes more than is required, it may carry forward the excess to offset future amounts for up to five years. The required distributable amount is equal to the foundation's minimum investment return, defined as 5% of the average monthly FMV of total assets, plus or minus certain adjustments.

A foundation may use any reasonable method for valuing total assets, including market quotations and appraisals. Fair market value must be recalculated each year, except for investments in real estate, which must be valued by independent appraisal no less than every five years. Allowed adjustments include reductions for acquisition indebtedness, cash held specifically for charitable activities, and taxes on investment income. See IRC § 4942.

Qualifying distributions are grants to accomplish the foundation's charitable purposes and may include reasonable and necessary administrative expenses and amounts paid to acquire assets used in carrying out the charitable purposes. Depreciation expense, excise taxes, and investment expenses are excluded.

SPEND IT PROPERLY—TAXABLE EXPENDITURES

Taxable expenditures are certain payments inconsistent with a foundation's charitable purposes. Officers of foundations probably understand the prohibitions on funding political propaganda or lobbying of legislators. However, they may not know that a grant to an individual for study, travel or "similar purposes" is also forbidden unless the grant meets any of several conditions of IRC § 4945(g). Taxable expenditures could bring on a 20% excise tax, with an additional 100% if not corrected upon notice or assessment. The penalties might not stop there. Foundation managers who knowingly, willfully and without reasonable cause agree to any taxable expenditure are subject to an initial tax of 5%, up to a maximum aggregate of $10,000.

Foundations must also be careful when making grants to organizations that are not public charities. A foundation must exercise "expenditure responsibility" with regard to grants made to nonpublic charities to avoid classification of the grants as taxable expenditures.

Foundation managers with responsibility for approving expenditures of any type should have a comprehensive understanding of the complex rules associated with taxable expenditures. Expenditure responsibility requires extra administrative and reporting measures (see Exhibit 2) to ensure a grant is spent only for the intended purpose and not for private or political gain.

Private foundations should consider two additional measures to prevent taxable expenditures. First, all expenditures with possible political implications

Exhibit 2 Requirements for Expenditure Responsibility

Pre-grant inquiry. A limited inquiry that provides basic information about a grantee organization and reasonable assurance that a grantee is capable of fulfilling the charitable purposes of a grant.

Written grant agreement. A written commitment signed by an appropriate officer of the grantee organization that includes spending and reporting responsibilities and an agreement to use grant funds only for the intended charitable purpose.

Reports from grantees. Grantees must file reports with a granting private foundation on the use of grant funds, compliance with the terms of the grant, and the progress made toward achieving the intended charitable purpose of the grant. Both annual reporting and a final report are required from the grantee. In addition, grantees that are not organizations described in IRC § 501(c)(3) must maintain grant funds in a separate account designated for charitable purposes.

Reports to the IRS. A foundation must report each grant with expenditure responsibility on its annual IRS Form 990-PF return.

Practice Tips

The CPA should:

- Ensure the client keeps a "real-time" list of disqualified persons.
- Advise private foundations with professional managers and paid trustees on issues regarding reasonable compensation.
- Educate private foundations about transactions that may be considered self-dealing acts and taxable expenditures.
- Help private foundations qualify for the 1% tax on net investment income.
- Assist private foundations with determining average fair market value of total assets used to calculate minimum investment return. Certain types of assets may require expertise in appraisal or other valuation techniques.
- Help private foundations meet expenditure responsibility requirements, when applicable.
- Educate private foundations about jeopardizing investments and excess business holdings.
- Help private foundations maintain the proper records to meet IRS reporting requirements.

should be carefully scrutinized to ensure they are not associated with lobbying for specific outcomes to legislation. Foundations should be aware of the various exceptions that allow for political expenditures to be excluded from taxable expenditures. Second, foundations should verify the status of public charities requesting a grant by checking the IRS Business Master File, available at no charge at **www.irs.gov/taxstats/charitablestats/article/0,,id=97186,00.html**. Guidestar has also incorporated information from the Business Master File into its fee-based Charity Check service (available at **www.guidestar.org/createUser.do?requestUrl=/services/cc.jsp**).

Invest Appropriately—Taxes on Jeopardizing Investments and Excess Business Holdings

CPAs with private foundation clients need to understand the investments included in the private foundation's portfolio to prevent excise taxes on jeopardizing investments. A 10% excise tax on each jeopardizing investment may be assessed against both the private foundation and the foundation manager (if the manager is willfully involved) for each year in which the jeopardizing investment is held. If the investment is not removed from jeopardy, additional excise taxes of 25% and 5% may be imposed upon the foundation and foundation manager, respectively.

A jeopardizing investment shows a lack of reasonable business care and prudence in providing for the short-term and long-term needs of a foundation in carrying out its exempt purpose. Although no single investment category is specifically considered jeopardizing, the following investment types should be considered only as part of a well-rounded portfolio:

- Trading in securities on margin
- Trading in commodity futures
- Investing in working interests in oil and gas wells
- Buying puts, calls and straddles
- Buying warrants
- Selling short

Program-related investments made by a foundation are never considered to be jeopardizing investments, even if the investment is income-producing or is considered high-risk. Program-related investments are made primarily to accomplish a foundation's exempt purposes rather than to produce income or capital appreciation.

Example. Two hypothetical private foundations, the Claire Foundation and the Hazel Foundation, recently made high-risk business loans to entrepreneurs interested in opening a shopping center in a very poor neighborhood. The primary exempt function of the Claire Foundation is to provide grants for world health initiatives, while that of the Hazel Foundation is to promote small business growth in economically disadvantaged communities.

The loans are directly related to the exempt purpose for the Hazel Foundation and, therefore, may be considered program-related investments. However, for the Claire Foundation, the loans may be

AICPA RESOURCES

Articles

- "Donor-Advised Funds: Preparing for Closer Scrutiny," *JofA*, Jan. 08, page 28
- "The Rich Truly *Are* Different," *JofA*, April 04, page 32
- "IRS Bite Beginning to Mirror Its Bark," *The Tax Adviser*, Aug. 07, page 439

Conference

AICPA Conference on Tax Strategies for the High-Income Individual, May 8–9, Las Vegas

For more information or to register, go to **www.cpa2biz.com** or call the Institute at 888-777-7077.

OTHER RESOURCES

IRS forms and publications

- IRS Publication 557, *Tax-Exempt Status for Your Organization*
- IRS Publication 578 (discontinued), *Tax Information for Private Foundations and Foundation Managers*
- IRS Instructions for Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*
- IRS Instructions for Form 4720, *Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*

Publications

- *Foundation Growth and Giving Estimates: Current Outlook*, Foundation Center, 2007
- *Pension Protection Act of 2006: Law, Explanation and Analysis*, CCH Inc., 2006

considered jeopardizing investments, since they do not significantly further its specific exempt purpose. The Claire Foundation and its managers need to assess whether reasonable business care was exercised in providing the loans.

Finally, the combined holdings of a private foundation and its disqualified persons are limited to 20% or less of the voting interest of a business enterprise. As a result, private foundations are not allowed to own a voting interest in business enterprises in which disqualified persons own 20% or more of the voting interest. Foundations may be allowed to increase ownership up to 35% if a third person not considered a disqualified person has effective control over the business enterprise in question. A de minimis rule allows a private foundation, together with all other private foundations, to own up to 2% of the voting stock or outstanding shares of all classes of stock of a corporation.

Reporting Requirements

Private foundations are required to file IRS Form 990-PF by the 15th day of the fifth month following the accounting year-end. The 990-PF includes financial and nonfinancial reporting components. The financial reporting component includes an analysis of revenues and expenses, a balance sheet and calculation of excise taxes on net investment income. The nonfinancial reporting component includes disclosures about self-dealing, undistributed income, taxable expenditures, expenditure responsibility, jeopardizing investments and excess business holdings. According to Pantzer, disclosure is crucial on certain items, including compensation, business holdings and self-dealing. Consulting with a client is imperative to determining how much to disclose as well as where best to disclose it on the relevant tax form.

Given the variety of complex tax regulations and reporting requirements faced by private foundations, CPAs can be an important resource in providing valuable expertise and advice. But as this overview shows, many situations could call for a specialist in this area. Thus, setting your clients' foundation on a firm footing—or helping them choose a different vehicle—and keeping it safe from potentially high penalties is a matter for thorough analysis of their philanthropic needs, goals and abilities. ❖

> CPAs need to understand the investments included in the private foundation's portfolio to prevent excise taxes on jeopardizing investments.

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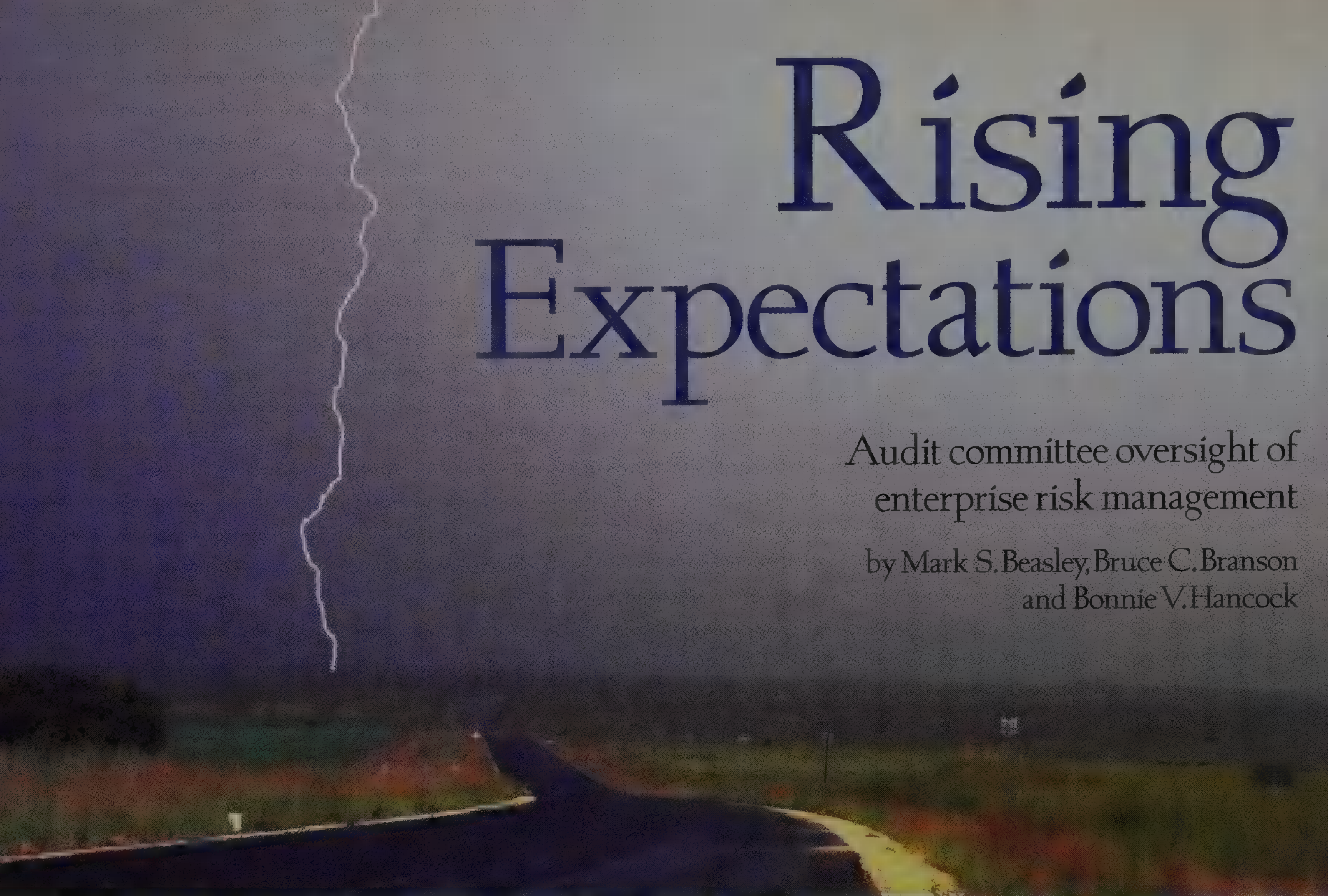

Rising Expectations

Audit committee oversight of enterprise risk management

by Mark S. Beasley, Bruce C. Branson and Bonnie V. Hancock

Recent events such as the massive trading losses at Société Générale, the subprime lending crisis and product recalls associated with Mattel's international toy manufacturing operations continue to shock financial markets and negatively impact shareholder value.

These events have also fostered rising expectations for boards of directors to exert greater oversight of their organizations' risk management processes, leading in turn to the growth of enterprise risk management (ERM) as a strategic planning tool.

Not only are key stakeholders pressuring boards to get a better handle on management's process for identifying, assessing and responding to specific risks, but stakeholders are also expecting boards to more effectively anticipate far-horizon risk exposures and to continually monitor those risks to ensure that strategic and operational decisions remain aligned with the organization's risk appetite. In response, more companies are turning to ERM.

Board's Role in Risk Oversight

Deloitte's *Global Risk Management Survey* (5th edition) reports that 70% of financial institutions participating in the survey place oversight responsibility for risk management with the board of directors, up from 59% in 2004 and 57% in 2002. This increase was due in part to emerging regulations, such as the New York Stock Exchange's 2004 *Final Corporate Governance Rules* that require audit committees to discuss and monitor risk management processes and Standard & Poor's 2007 proposed scoring of ERM quality as part of the rating agency's credit evaluations (see description in Exhibit 1).

Boards are also beginning to embrace their responsibility for oversight of various enterprise risks. In the process, many are finding that better risk intelligence is a significant aid to their strategic planning responsibilities. The Conference Board's 2006 report, *The Role of U.S. Corporate Boards in Enterprise Risk Management,* found that a majority of boards believe strategic risks pose the greatest threat to the company and that more risk intelligence would be helpful to them when considering risk/return trade-offs as they evaluate various strategic alternatives.

Delegation to Audit Committees

In many companies, boards are assigning the additional task of risk oversight to the audit committee, despite the audit committee's already lengthy list of responsibilities related to financial reporting and the internal/external audit function. Not only are audit committees being charged with overseeing management's risk policies and guidelines, they are also being asked to discuss with management the enterprise's key risk exposures—including those beyond financial reporting related risks. The Conference Board's recent analysis of *Fortune* 100 audit committee charters found that 66% place risk responsibility on the audit committee, in manners similar to the examples illustrated in Exhibit 2 for

Reynolds American, MasterCard Incorporated and Harley-Davidson.

Audit committees (or other board committees) charged with risk oversight are placing demands on management for more information about risk management processes and for up-to-date information about management's assessment of key risk exposures. Chief financial or accounting officers are often taking the lead in risk management efforts internally. The Conference Board's 2006 report, based on interviews of board members of U.S. public companies, found that the CFO was the executive most frequently cited by directors as being responsible for informing the board on risk issues—with more than 70% reporting this relationship. However, in growing numbers, organizations are creating chief risk officer (CRO) positions to serve as the risk leader or "champion," while others are creating executive-level risk committees composed of the CFO, CRO, general counsel, executives in charge of strategy and internal audit, or other key business unit leaders.

Formalizing Risk Management Processes

The volume and complexities of risks affecting the enterprise continue to expand, and boards and senior executives are increasingly feeling the pressure to respond. In fact, Ernst & Young's 2006 report, *Board Members on Risk*, finds that 72% of board members surveyed believe that the overall level of risk that companies face has increased in the past two to three years, with 41% indicating that the overall level of risk has increased significantly. Executives and their boards are realizing that the days of managing risks informally or on an ad hoc basis are no longer acceptable and that their current controls are inadequate in today's rapidly evolving business world. This is consistent with IBM's *Global CFO Study 2008* that reported 62% of enterprises with revenues over $5 billion have encountered a major risk event that substantially effected operations or results in the last three years; and nearly half (42%) stated that they were not adequately prepared.

In response, many boards have adopted ERM as a process to develop a more robust and holistic top-down view of key risks facing the organization. To help boards and management understand the critical elements of an enterprise-wide approach to risk management, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued in 2004 its *Enterprise Risk Management—Integrated Framework* that outlines eight critical components of effective enterprise risk management (see exhibits 3 and 4).

While the embrace of ERM is largely in response to emerging expectations for greater risk oversight, recent data from the IBM study find that entities that outperform their peers are more likely to have developed a more formal risk management process. Proponents of ERM stress that the goal of effective ERM is not to lower risk. Rather, ERM is designed to more effectively manage risks on an enterprise-wide basis so that stakeholder value is not only preserved, but enhanced. ERM allows the board and management team to make more holistic "risk-intelligent" strategic decisions.

As boards and executives focus on the ERM process, they are thinking more about risks affecting the company as a whole. This is different from traditional approaches to risk management where management typically assigns risk oversight responsibilities to individual functions or business units (often referred to as "silos"). The result of a

ERM allows the board and management team to make more holistic "risk-intelligent" strategic decisions.

EXECUTIVE SUMMARY

■ **More companies are placing oversight responsibility for risk management with the board of directors.** While embracing this responsibility, boards are also finding that better risk intelligence is a significant aid to their strategic planning responsibilities.

■ **In many companies, boards are assigning the additional task of risk oversight to the audit committee.** Audit committees (or other board committees) charged with risk oversight are placing demands on management for more information about risk management processes and for up-to-date information about management's assessment of key risk exposures.

■ **The volume and complexities of risks affecting the enterprise continue to expand.** In response, many boards have adopted ERM as a process to develop a more robust and holistic top-down view of key risks facing the organization.

■ **Because an ERM approach to risk management involves a top-down view of risks, leadership from senior executives is a critical component to an effective ERM process.** The CFO is uniquely positioned to lead the overall enterprise risk management effort.

■ **Most experts argue that internal audit's role should be to monitor the effectiveness of ERM** processes designed and implemented by senior management.

■ **Audit committees are also exerting pressure on their external auditors to share risk information** they glean from audits of financial statements, and the audit of internal controls over financial reporting for publicly traded entities.

■ **Implementing ERM is an evolutionary process**, whereby risk oversight improves over time.

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Exhibit 1 Governance Expectations for Board Risk Oversight

1. Excerpt from the NYSE's 2004 *Final Corporate Governance Rules*[1]

Among numerous other responsibilities, duties and responsibilities of the audit committee include:
(D.) discuss policies with respect to risk assessment and risk management;

Commentary: While it is the job of the CEO and senior management to assess and manage the company's exposure to risk, the audit committee must discuss guidelines and policies to govern the process by which this is handled. The audit committee should discuss the company's major financial risk exposures and the steps management has taken to monitor and control such exposures. The audit committee is not required to be the sole body responsible for risk assessment and management, but, as stated above, the committee must discuss guidelines and policies to govern the process by which risk assessment and management is undertaken. Many companies, particularly financial companies, manage and assess their risk through mechanisms other than the audit committee. The processes these companies have in place should be reviewed in a general manner by the audit committee, but they need not be replaced by the audit committee.

2. Excerpt from Standard & Poor's *PIM Framework for Assessing ERM Practices*[2]

In November 2007, Standard & Poor's issued a request for comment titled, *Criteria: Request For Comment: Enterprise Risk Management Analysis For Credit Ratings Of Nonfinancial Companies*, that announces S&P's proposal to expand its analysis of ERM processes as part of its credit rating assessments into 17 different industries.[3] S&P has developed an ERM assessment framework—the "PIM Framework" denoting Policies, Infrastructure and Methodology—to assess the robustness of enterprise risk management practices within an entity as part of the credit evaluation process. Within the PIM Framework, S&P views "risk governance" as the foundation of the evaluation structure. Several components of risk governance include activities involving the board of directors, such as:

- *In consultation with the business, the institution has established risk policies that would be approved by the board's risk committee;*
- *The institution ensures that periodic dialogue takes place among the board, business heads, and group risk management on the appropriateness and relevance of the various key financial and nonfinancial risk metrics;*
- *Ensure that the board is well engaged with ERM initiatives within the organization and is to some degree setting the tone.*

1. New York Stock Exchange, *Final Corporate Governance Rules*, 2004 (**www.nyse.com/pdfs/finalcorpgovrules.pdf**).
2. Standard & Poor's, *Assessing Enterprise Risk Management Practices of Financial Institutions*, 2006 (**www2.standardandpoors.com/spf/pdf/products/ICR_Article_CriteriaAssessingEnterpriseRisk.pdf**).
3. Standard & Poor's, *Criteria: Request For Comment: Enterprise Risk Management Analysis For Credit Ratings Of Nonfinancial Companies*, 2007 (**www2.standardandpoors.com/portal/site/sp/en/us/page.article/3,1,1,0,1148449315878.html**).

silo approach is that risks are often managed inconsistently or according to each manager's personal tolerance for risk. More importantly, while risks may be managed within an individual business unit to acceptable levels, those risk responses may unknowingly increase or create risks for other units within the organization. In the end, when risks are managed in silos, the result is often an increase (rather than reduction) in net risk for the enterprise.

Senior Executive Leadership in Risk Management

Because an ERM approach to risk management involves a top-down view of risks, leadership from senior executives is a critical component to an effective ERM process. Those who have started down the ERM path can attest to the reality that the embrace of a holistic view of risks, where risk information is shared transparently across silos within the organization, requires a significant change in culture or mind-set of leaders within the enterprise. As employees throughout the organization are held accountable for the ownership of risks within their areas of responsibility, senior executives need to reinforce the importance of embracing this new mind-set toward a more transparent, enterprise-wide view of risk management.

The CFO is uniquely positioned to lead the overall enterprise risk management effort. CFOs are intricately involved in providing an overall view of the enterprise from a financial perspective, which gives them an enterprise-wide understanding of key activities driving both financial and operational performance. Furthermore, they have an established relationship with the audit committee. Thus, as audit committees turn to management to strengthen the enterprise's approach to risk management, they are naturally turning to CFOs to jump-start the process.

CFOs are responding to these new challenges by first designing basic structures for identifying and assessing risks across the enterprise. For many, this begins by defining risk terminology or developing common definitions of key risk concepts so that risk

management approaches are implemented consistently across the enterprise. Providing clear definitions of risk terms (including discussion of whether "risk" represents both risk opportunities and risk threats) is often the required first step.

Exhibit 2 Sample Audit Committee Charter Discussion of Risk Management

Below are excerpts from three audit committee charters that provide examples of audit committee involvement in risk oversight:

- Reynolds American Inc.'s *Audit Committee Charter* states that one of the six purposes of the audit committee of the board of directors includes (see **www.reynoldsamerican.com**):

  4. Overseeing that management has established and maintained processes to ensure adequate enterprise risk management;

- MasterCard Incorporated's *Audit Committee of the Board of Directors Charter* explicitly identifies 33 specific functions of the audit committee, one of which includes the following responsibility to (see **www.mastercard.com**):

  28. Discuss with management and the independent auditors the Corporation's guidelines and policies with respect to risk assessment and risk management. The Committee should discuss the Corporation's major financial and other risk exposures and the steps management has taken to monitor and control such risk exposures.

- Harley-Davidson's *Audit Committee Charter* includes the following duty as one of its principal recurring processes of the audit committee (see **www.harley-davidson.com**):

  7. Discuss with management the Company's major risk exposures and the steps management has taken to monitor and control such exposures, including the Company's risk assessment and risk management policies.

Exhibit 3 COSO's Definition of Enterprise Risk Management

In 2004, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued its *Enterprise Risk Management—Integrated Framework* with this definition of ERM:

Enterprise risk management is a process, effected by the entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within the risk appetite, to provide reasonable assurance regarding the achievement of objectives.[4]

4. Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Enterprise Risk Management—Integrated Framework*, September 2004, **www.coso.org**, New York, N.Y.

Second, once risk is defined, senior management can then look across the organization to identify potential risk drivers and risk events through surveys, interviews, risk workshops and external risk scanning to generate an inventory of risks affecting the enterprise.

Third, when risks are identified, leaders need to ensure that risks are assessed consistently across the organization. Risk champions at the senior executive level need to develop procedures to govern how risks are to be assessed, not only from a likelihood or probability perspective, but also from an impact perspective in order to prioritize those risks most important for senior executive and board oversight.

Finally, based on risk rankings reflecting probability and impact assessments, management is now in a position to identify those risks with the greatest need for development of an appropriate risk response. Senior executives may then develop key risk indicators that they can include in management information reports to allow for proactive management of these risks on an ongoing basis. Exhibit 5 provides an example of how an entity might define guidelines for probability and impact assessments.

While providing an abbreviated overview of the core elements of an ERM approach, the above discussion illustrates the nature of risk management leadership the audit committee or board is expecting from senior executives. To assist them in developing these procedures, many executives are turning to COSO's *Enterprise Risk Management—Integrated Framework* to understand in more depth the critical elements of an effective approach to ERM. In addition to the COSO framework, many have found useful the ERM frameworks illustrated in the Australian/New Zealand Standard 4360, *Risk Management*, and the United Kingdom's Turnbull report, *Financial Reporting Council Internal Control: Revised Guidance for Directors on the Combined Code*.

INTERNAL AUDIT'S SEAT AT THE TABLE

While the CFO or other senior executives are formally leading ERM efforts, internal

audit plays a major role in supporting the process. In many cases, general audit executives who lead the internal audit function have been the first to take the lead in the launch of ERM. In fact, a 2005 study reported in *Internal Auditor* (conducted by one of the authors of this article) found in a survey of general audit executives that most have informally served as the chief risk officer when the organization had not formally designated an individual to serve in that role. When the entity has a CRO, the study found a great deal of interaction between the general auditor and the CRO, with 77% indicating their interactions range from regular to very close.

While internal audit is naturally involved in risk management activities, an Institute of Internal Audit position paper, *The Role of Internal Auditing in Enterprise-wide Risk Management*, indicates that there are specific roles internal audit function should and should not assume throughout the ERM process. According to the position paper, internal audit should provide core roles in giving assurance on risk management processes, giving assurance that risks are evaluated correctly, evaluating risk management processes, evaluating the reporting of key risks, and reviewing the management of key risks.

But internal audit should not be involved in developing the risk management process for board approval, imposing risk management processes, making decisions on risk responses, managing identified risks, or setting the enterprise's risk appetite. Most argue that internal audit's role should be to monitor the effectiveness of ERM processes designed and implemented by senior management. Direct reporting of the internal audit function's monitoring activities puts audit committees in a position to be more objectively informed about the effectiveness of management's risk management processes, including the accuracy and completeness of risk information they receive directly from senior management.

Exhibit 4 COSO's Eight Components of Enterprise Risk Management

1. ***Internal Environment***. The internal environment encompasses the tone of an organization and sets the basis for how risk is viewed and addressed by an entity's people, including risk management philosophy and risk appetite, integrity and ethical values, and the environment in which they operate.
2. ***Objective Setting.*** Objectives must exist before management can identify potential events affecting their achievement. Enterprise risk management ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.
3. ***Event Identification.*** Internal and external events affecting achievement of an entity's objectives must be identified, distinguishing between risks and opportunities. Opportunities are channeled back to management's strategy or objective-setting processes.
4. ***Risk Assessment.*** Risks are analyzed, considering likelihood and impact, as a basis for determining how they should be managed. Risks are assessed on an inherent and a residual basis.
5. ***Risk Response.*** Management selects risk responses—avoiding, accepting, reducing or sharing risk—developing a set of actions to align risks with the entity's risk tolerances and risk appetite.
6. ***Control Activities.*** Policies and procedures are established and implemented to help ensure the risk responses are effectively carried out.
7. ***Information and Communication.*** Relevant information is identified, captured, and communicated in a form and time frame that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across and up the entity.
8. ***Monitoring.*** The entirety of enterprise risk management is monitored and modifications made as necessary. Monitoring is accomplished through ongoing management activities, separate evaluations, or both.

EXTERNAL AUDIT AS AN INDEPENDENT SOURCE OF KEY RISK IDENTIFICATION

Audit committees are also exerting pressure on their external auditors to share

AICPA RESOURCES

Web site
Audit Committee Effectiveness Center, **www.aicpa.org/audcommctr**

Management Accounting Guidelines
- *Integrating Social and Political Risk into Business Decision Making*
- *The Reporting of Organizational Risks for Internal and External Decision Making*
- *Identifying, Measuring and Managing Organizational Risks*

All Management Accounting Guidelines may be downloaded for free at **http://fmcenter.aicpa.org/Resources/Management+Accounting+Guidelines/Available+Management+Accounting+Guidelines.htm.**

OTHER RESOURCES

Web site
ERM Initiative at North Carolina State University's College of Management, **www.erm.ncsu.edu**

Exhibit 5 Examples of Defining Risk Probability and Impact Assessments

The following is an example of how an entity might assess risk likelihood and impact using a 10-point scale:

<u>Likelihood</u>	<u>The risk…</u>
Rare (1–2)	Has a negligible probability of impact in the next 12–24 months
Unlikely (3–4)	Has a low probability of impact in the next 12–24 months
Possible (5–6)	Has a medium probability of impact in the next 12–24 months
Likely (7–8)	Has a high probability of impact in the next 12–24 months

<u>Severity</u>	<u>The risk may have…</u>
Insignificant (1–2)	Almost no financial implications
Minor (3–4)	A minimal impact on financial performance
Moderate (5–6)	A significant impact on financial performance
Major (7–8)	A substantial impact on financial performance requiring multiyear recovery
Extreme (9–10)	A significant impact on corporate solvency

risk information they glean from audits of financial statements and the audit of internal controls over financial reporting for publicly traded entities.

Also, for private companies and not-for-profit organizations, the external auditors are likely to identify key business risks affecting the enterprise in the process of understanding the entity and its environment now required by the Risk Assessment SASs (Statement on Auditing Standards nos. 104–111).

Auditors of publicly traded companies may also identify deficiencies in risk responses as they assess the effectiveness of internal controls surrounding core business processes that affect financial reporting. Proactive audit committees are recognizing the external auditor as a vital source of risk information that can assist them in challenging the completeness of risks identified by management. External auditors are recognizing this need and are responding with greater dialog about key risks when participating in executive sessions with the audit committee.

ERM Takes Time—Setting Realistic Expectations

While boards and senior executives are rapidly ramping up their risk oversight processes, few entities can claim that they have fully developed ERM processes in place. Most recognize that implementing ERM is an evolutionary process, whereby risk oversight improves over time. In fact, a 2007 Conference Board survey notes that it is fair to think of ERM as being in the "adolescent stage." Most ERM proponents believe there is no "one-size-fits-all" approach. As boards and senior management strive to make real progress toward developing ERM processes into more mature business operating models, they will need to be patient. Immediate success is rare—ERM must be viewed as a long-term cultural change, and realistic expectations must be established for its implementation. ❖

Trust-Owned Life Insurance: The CPA's Role

Exposures related to serving as a trustee

by Don Deans and William B. Nicholson

Many CPAs recommend that their high-net-worth clients use trust-owned life insurance (TOLI) as the cornerstone of their estate plan. In addition, many CPAs choose to serve as trustees of such trusts. CPAs who are considering accepting a trustee designation should be well aware of the hazards inherent to the task and make sure they have the skills and knowledge to take on the challenge, which will usually involve some specific training in life insurance.

Even if they shun this weighty responsibility, CPAs can still serve critical client needs in this area. This article is designed to help CPAs decide whether to accept the trustee designation. If they do accept it or are already a trustee, they can assess their approach against fiduciary requirements and best practices. With the passage of the Uniform Prudent Investor Act in the mid-1990s, trustees' fiduciary duties are held to a higher standard than under previous law. Many of those practices, however, also apply to life insurance generally, whether or not a trust is involved.

As trusted advisers, CPAs have an obligation to educate their clients about the pending crisis in TOLI. A real problem looms on the horizon. Certain studies have shown that more than 25% of nonguaranteed flexible TOLI policies will lapse during the insured's lifetime ("TOLI Risk Management at Litigation Crossroads," *Steve Leimberg's Estate Planning Email Newsletter*, no. 1110, April 12, 2007). You should take the opportunity to work with a competent insurance professional to protect your clients' plans and assist your clients in developing a best-practices review for their TOLI.

In many cases, CPAs can best serve their clients by assisting them with obtaining a competent corporate fiduciary, or trust company, to serve as trustee. CPAs should also advise clients against choosing as the trustee a family member who knows nothing about life insurance.

Ed Linsley, senior vice president and manager of personal trust at Reliance Trust Co., recommends evaluating a trust

company by how long it has been in business, how much in assets it manages, whether it has local representation to serve the client, and whether its fees are reasonable. Also, inquire whether the trust company does business in irrevocable life insurance trusts (ILITs). If so, how many trusts does it administer and does it audit them?

THE POLICY

Permanent life insurance policies sold over the last 25 years have typically been whole life or flexible premium nonguaranteed policies (universal, variable universal and adjustable life products) or a blend of each with term insurance. Whole life contracts provide for a guaranteed fixed premium, death benefit and cash surrender value. Universal and adjustable life policies are sensitive to the short-term credit rates offered by the insurance carrier, while variable life policies are invested in mutual fund-like subaccounts. Flexible premium insurance contracts provide limited guarantees while affording the policyholder flexibility as to the amount and timing of premium payments. Unless they are funded properly and sufficiently and actively managed, the flexible products run the risk of terminating with no value and no death benefit.

When the investment subaccount or interest rates rise or remain relatively constant as compared to the illustrated rate, flexible contracts tend to perform reasonably well. However, in recent years, interest rates have fallen sharply and are significantly lower than the interest rates illustrated when many of these policies were purchased. Similar results occurred for variable policies after the stock market downturn from 2000 to 2002. Consequently, many of these policies are in danger of lapsing.

Let us consider the fate of a variable universal policy issued in 1999, for example. The Standard & Poor's 500 index took more than six years (79 months) to regain its value from August 2000 to May 2007. If the premiums were not increased to reflect the market losses, the policy might have been in serious trouble. Likewise, for a universal life policy issued in the early 1980s, the premium was calculated with an annual assumed interest rate of about 14%. The rate today is 4%. Accordingly, if the premium were not increased substantially, the policy would have lapsed. Additionally, most flexible premium policy illustrations are calculated with the highest interest rate and lowest premium allowed. This may increase sales but does not help prevent policy lapses.

> CPAs can best serve their clients by assisting them with obtaining a competent corporate fiduciary, or trust company, to serve as trustee.

THE ILLUSTRATION

How is the policy owner—or a CPA trustee or adviser to the policy owner—to know if the policy has issues? The original illustration is generally of no help. Life insurance illustrations are simply computer printouts that show various aspects of the policy such as premiums, cash values and death benefits under interest crediting rate assumptions. The insurance company is not required to meet these estimates. The only certainty about illustrated values is that the policy's actual performance will differ from them as markets change.

Sometimes the annual policy statement contains footnotes that can highlight a problem. Generally, however, the only way to know how a policy is performing is to order an in-force reprojection. The in-force reprojection is a re-illustration of the policy from the present as a projection of values into the future based on current mortality costs. For a universal life policy, it includes an assumed interest crediting rate or, for a variable universal life policy, the assumed subaccount yield. It will determine whether the current premium is sufficient to carry the policy to maturity or should be increased. This should be requested and analyzed annually.

THE TRUST

In many cases, the agent never sees the insured after policy delivery. The policyholder, not understanding insurance illustrations

EXECUTIVE SUMMARY

- **CPAs with specific training and understanding of life insurance in estate planning sometimes are trustees** of trust-owned life insurance (TOLI). With the complexity of many policies, responsibilities of annual policy review and fiduciary duties under the Uniform Prudent Investor Act, however, many may decide to serve their clients by helping them select a trust company to handle TOLI management and then continue to advise the grantor and monitor the trust's performance.
- **Whether the trustee is a CPA or other professional**, the trustee should ensure premiums are sufficient to cover any decrease in interest rate for universal life policies or investment subaccount results for variable universal life. Shortfalls may result in a loan that in the case of a policy lapse could cause cancellation-of-debt taxable income to the client.
- **The annual policy review should also check for** proper crediting of premiums and titling of ownership and beneficiaries, and evaluate the performance of the insurance carrier and the policy, using an in-force reprojection. If the policy is underperforming, options may include replacing the policy or selling it in a life settlement.

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and how policies work, oftentimes files the policy away in a lockbox—as if it were guaranteed. In the case of a lapsing policy with a loan, the policy owner can even become subject to income tax due to the forgiveness of debt. Likewise, if a trustee or grantor forgets to pay the premium or assumes no premium is due when in fact it is, most insurance companies will automatically pay the premium to keep the policy in force and then count those premiums as a loan. The trustee and the grantor may be unaware of this loan and consequently unaware of the accruing interest on that loan as well.

In the estate-planning arena, where the use of TOLI is prevalent, life insurance is often used to provide sufficient liquidity to fund estate taxes and final expenses. Trustees—even CPAs—of ILITs typically are not skilled life insurance specialists and do not recognize that a life insurance contract is a complicated financial instrument. Many trustees do nothing more than pay premiums and send out the Crummey notices. (Crummey notices give beneficiaries the option of demanding withdrawal of gifts to the trust before the gifts become the property of the trust. Without Crummey powers, the donor to the trust risks losing the annual gift tax exclusion.)

A recent study in the *Journal of Financial Service Professionals* ("Trust-Owned Life Insurance: Issues Trustees Face; Decisions Trustees Need to Make," July 2005, page 39) indicates that anywhere from 70% to 95% of TOLI had no servicing agent. A survey in *Trusts and Estates* found that 83.5% of professional trustees had no guidelines or procedures for handling TOLI and 95.3% had no investment policy statement covering TOLI ("The Problem With Trusts Owning Life Insurance," May 2003, page 62). Additionally, only 28.8% of nonprofessional trustees had reviewed TOLI within the last five years.

Thus, the problem is that the trustees have neither the life insurance skills to manage TOLI, nor the procedures in place to do so. Exacerbating the problem is that the insurance agent is no longer involved.

The Regulations

Further compounding the task facing trustees is the legislative action involving the Uniform Prudent Investor Act (UPIA). The National Conference of Commissioners on Uniform State Laws drafted the UPIA as a model act in 1994 (see "Put Your Trust in Trustees," *JofA*, Nov. 98, page 69). It has been in force in various forms in the majority of states since then. This act holds a trustee to a higher level of conduct and provides means to enforce those standards. The trustee must act in a fiduciary capacity to achieve the objectives stated in the trust.

Trustees—even CPAs—of ILITs typically are not skilled life insurance specialists and do not recognize that a life insurance contract is a complicated financial instrument.

Additionally, the UPIA implies that life insurance should be treated as an asset class. This requires the trustee to monitor the quality of assets given to the trust and to assess the risk tolerance of the trust. A CPA who is not a trustee can double-check to make sure the trustee is performing those duties. If the trustee is a family member, then it's all the more advisable for the CPA to play a more active role, by advising the family trustee.

In short, life insurance policies are complex financial investments. Life insurance expertise among trustees is limited, and regulations involving TOLI have become more rigorous. The question now becomes, how do I assist my clients with their TOLI? Here is the silver lining—the complexity provides an opportunity for additional services to your clients.

Trust Investment Policy Statement

Every grantor with a TOLI needs to have an actively managed, dynamic review process. The trustee must have a documented process for TOLI reviews. The review should begin with a trust investment policy statement (TIPS). Only 4.7% of TOLI has such a policy statement (see "The Problem With Trusts Owning Life Insurance," cited above). The TIPS should provide a road map for managing the policy. Goals and objectives should be established, the criteria for the selection and/or replacement of the insurance carrier should be included, and an action plan for policy evaluation should be delineated.

The TIPS should also spell out what to do if a policy fails to perform. This document provides the foundation for the trustee's responsibilities.

The Policy Review

For CPAs who are trustees of TOLI, we feel that the trust should be reviewed annually to protect grantors from unforeseen changes and to protect CPAs from legal exposure resulting from changes in the original scenario. This review should include the following steps:

Administrative review. Ensure that premiums are properly and timely credited to the policy; check for errors that may have been made by the insurance company; and verify that insurance titling (ownership and beneficiaries) is correct.

Insurance carrier review. The insurance carrier's financial integrity should be evaluated. Economic circumstances confirmed by rating agencies may provide a higher level of risk than the TIPS allows.

Policy performance review. The trustee must consider many factors. At a minimum, the trustee should order an in-force illustration from the insurance carrier. The in-force reprojection allows the trustee to determine how the policy might perform based upon current facts rather than the original illustration. The policy should then be sensitivity tested using various assumptions to determine how it might perform with different economic variables.

Obviously, a variable life policy should also be reviewed in terms of subaccount performance and risk. The trustee should consider hiring a money manager to monitor the investments within the policy.

At this juncture, the trustee should have enough data to determine if the policy is performing under the TIPS. If it is performing, then document your procedures and perform the review next year. If it is not performing, the trustee should consider remediation.

> The trustee should consider hiring a money manager to monitor the investments within the policy.

Optimization review. Optimization may vary from negotiating with the current insurance carrier to replacing the insurance policy, to selling the policy in a life settlement. Facts in each situation will vary based upon the insured's health and economic situation.

Negotiation with the current carrier might include having the carrier lower mortality rates based upon current mortality tables, reducing the death benefits or adjusting premium payments.

If the insured's health has not changed appreciably, the trustee should shop the policy. There have been changes in mortality, underwriting and policy design whereby the insured may obtain a new policy with the same or improved death benefit at substantially lower cost. One study indicated that there was a 75% chance that with no increase in premiums, a policy's face amount could be increased 40% or more through the acquisition of a new policy (*American Banker*, vol. 163, no. 22, page 17, Feb. 3, 1998). The insurance industry is constantly evolving, with new products containing new guarantees and riders.

If the insured's economic or life circumstances have changed, explore a sale of the policy in the life settlement market. This process should be considered when the purpose of the trust has become obsolete and the fair value of the policy exceeds any other benefit.

A Firm Foundation

These suggestions will enable you to not only solidify your relationship with your high-net-worth clients, but will allow you to market this relationship to other high-net-worth clients.

Life insurance is frequently the bedrock upon which a client's financial estate plan is built. We recommend that, if your clients have nonguaranteed flexible policies that are more than 10 years old, you and your insurance professional contact them to begin a best-practices review. You need to ensure that their foundation is not on shifting sand. ❖

AICPA RESOURCES

JofA articles

- "Turn Unneeded Policies Into Cash," Sept. 05, page 39
- "Understanding Life Insurance Illustrations," Feb. 03, page 70
- "Put Your Trust in Trustees," Nov. 98, page 69

Publications

- *The New Fiduciary Standard: The 27 Prudent Investment Practices for Financial Advisers, Trustees, and Plan Sponsors* (#017242)
- *The Adviser's Guide to the Revised Trust Accounting Rules* (#061073PDF)

For more information or to make a purchase, go to **www.cpa2biz.com** or call the Institute at 888-777-7077.

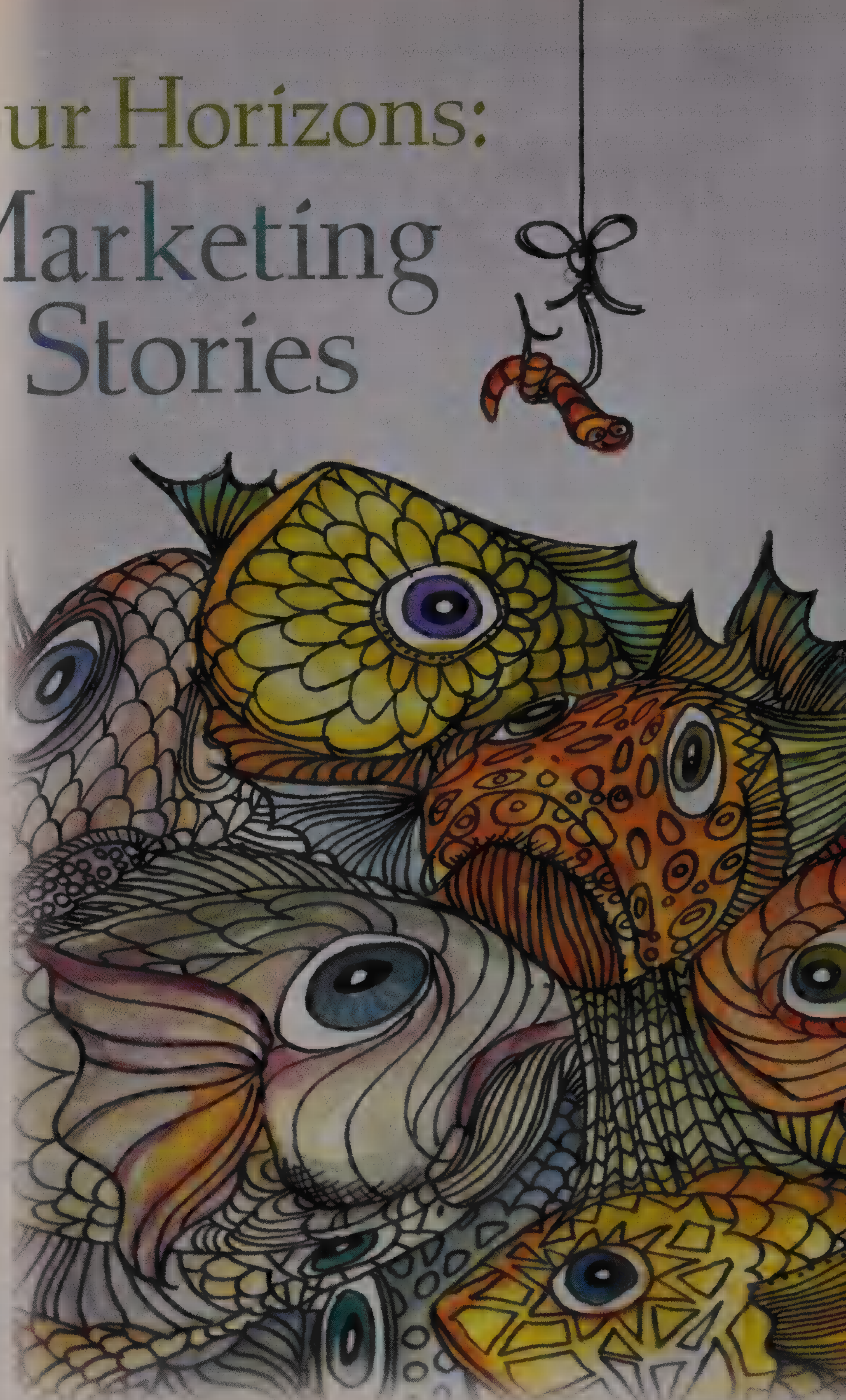
OTHER RESOURCES

Web site

Uniform Prudent Investor Act, **www.law.upenn.edu/bll/archives/ulc/fnact99/1990s/upia94.pdf**

Expand Your Horizons: Niche Marketing Success Stories

by Jean Marie Caragher



Niche marketing has become a successful strategy for many CPA firms because it identifies target markets and resources, distinguishes a CPA firm from the competition and generates higher profit margins. Niche market specialties will focus both your firm's marketing program and your marketing professional's activities by providing a foundation for marketing plans and goal setting. This article will provide you with the keys to successful niche marketing as well as niche marketing success stories.

The Keys to Successful Niche Marketing

For purposes of this article, niche markets include specific industries (for example, manufacturing, real estate), services (for example, forensic accounting, business valuation), or other buyer groups that have distinctive characteristics (for example, public companies, family businesses). To identify niche opportunities, develop a marketing plan that includes the following components:

Mission statement. A brief statement of your firm's basic purpose. Your mission statement should answer the following questions: What do we do? How do we do it? For whom do we do it?

Situation analysis. Describes the current status of your firm, the niches you wish to pursue, and your competition.

SMART goals and strategies. SMART goals are specific, measurable, attainable, realistic and timely. Strategies are the action items that will help achieve your goals. For each strategy be sure to include the people responsible for implementation and deadlines.

Implementation. Successful niche marketing plan implementation requires:

- Active support from the firm's managing partner.
- Commitment to the plan by the entire group responsible for implementation, including the necessary skills.
- One person with the ultimate re-

sponsibility for implementation.

- A client/prospect database.
- A system to track prospects, leads, proposals, new and lost clients.
- Incentives.
- Resources.

Budget. On average, CPA firms invest between 2% and 4% of net revenue on marketing.

Develop a niche champion. Without a champion you do not have a niche. The niche champion has the knowledge of the industry or service, is willing and able to lead a team, has the respect of the partners, and has the desire to become a famous person. A famous person is known for their industry or service expertise, attains leadership positions in trade organizations, knows industry vendors and media, publishes articles, and presents seminars and speeches.

FOCUS YOUR MARKETING PROGRAM

Tauber & Balser PC in Atlanta used a niche marketing strategy to focus its marketing program. After Capstone Marketing conducted a marketing audit in 2003, several niches were identified, including forensic accounting, public companies, not-for-profit organizations, and, subsequently, family businesses. Developing these areas along with providing marketing training, establishing marketing skills by level to guide all employees, and implementing a rewards-and-recognition program enabled the firm to double its revenue in three years to nearly $14 million.

"Niche marketing is the single most important reason for our firm's growth and profitability," says Mark Murovitz, CPA, managing shareholder.

"Today, firms need to become famous for the specialized services they provide not only to remain competitive in the business marketplace, but to retain and attract staffing talent from a limited pool of human resources," says Leslie Balmforth, CPA, principal and chief operating officer. "Our professional development program focuses on developing staff in our targeted niche areas by providing the necessary training for certifications and designations and the experience and opportunities to become specialists."

The firm uses a variety of marketing tools to promote its niches, including newsletters, seminars, publishing articles and networking. "We know the importance of market awareness and getting our name out there," Balmforth says.

Niche teams regularly meet to review the status of marketing programs. Each niche has a marketing plan and champion. "The challenge of niche marketing is finding a champion who is committed to making it happen," Murovitz says. "A lack of commitment may occur because CPAs, in general, are risk averse. It's easier taking care of existing clients rather than going out on a limb to develop a new area. You may have to go through a few people before you get the right one."

NICHE TO COMPETE AGAINST LARGER FIRMS

Jay Goldstein, CPA, has witnessed the evolution of Friedman LLP's real estate practice. A partner and chairman of the firm's real estate practice, Goldstein joined the firm in 1969. The firm had a few real estate clients, two of which grew into large, prestigious real estate developers in New York. Today, the real estate niche represents 45% of the firm's revenue.

"In the 1990s we started to look at the

EXECUTIVE SUMMARY

- **By identifying target markets and resources,** niche marketing can distinguish a CPA firm from its competitors while generating higher profit margins.
- **A well-developed marketing plan is the key** to successful niche marketing and can include, but is not limited to, the following components: a mission statement; situation analysis; and SMART (specific, measurable, attainable, realistic and timely) strategies.
- **Find a niche champion** with the industry knowledge (and experience), respect of partners and the ability to lead a team. If you lack champions, consider hiring and/or merging with industry specialists.
- **Focus your marketing program** using a variety of marketing tools and activities, and implement your strategy consistently.

Jean Marie Caragher is president of Capstone Marketing, Chesapeake, Va. She can be reached at jcaragher@capstonemarketing.com.

Reveal Niches With a Marketing Audit

A marketing audit can help identify target markets for your firm. A marketing audit evaluates various internal and external components. The most important components related to niche marketing include:

Firm profile. Organization charts, billing rates, financial statements.

Partner profile. Partners' personal and professional objectives, firm's specialties, age and tenure with the firm.

SWOT analysis. Strengths, weaknesses, opportunities and threats.

Client analysis. Analyze your clients by industry, fees, number, historical information, fee/growth trends, and how they became clients. Create a profile of your current client base for the past three years including:

- Total standard fees
- Total net fees
- Net fees for each service area
- Chargeable hours for each service area
- List of clients in descending order by fees collected for the past three years

Also, list your clients by SIC/NAIC code and include for each client:

- Standard fees
- Net fees
- Standard fees for each service area (for example, assurance, tax)
- Net fees for each service area
- Total chargeable hours
- Chargeable hours for each service area

Your client analysis should also include a list of clients by geographical location, annual sales, and a list of lost clients for the most recent fiscal year and the reason for the loss.

real estate practice as a niche," explains Goldstein. "We did some rudimentary marketing, placing ads in trade magazines, joining industry associations, writing articles and giving speeches. We started to formalize our niche marketing efforts in 1999 when Carol Schrager joined Friedman LLP as director of marketing."

"Our marketing efforts are now more planned," he continues. Friedman LLP sponsors three seminars per year, exhibits in five trade shows annually, advertises in real estate publications, and participates in local and national trade associations. New business opportunities and other marketing statistics are regularly tracked.

"We take pride in being able to compete against larger firms," Goldstein says. "Medium-sized firms can show their expertise in a niche area without having a client subjected to the bureaucracy of larger firms. Niche practices focus on smaller areas and growing the practice.

"Niche marketing has had a significant impact on our firm," he says. "It focuses the marketplace on Friedman LLP. To really grow a niche, know the problems your clients face, provide suggestions regarding accounting, tax, and organizational issues—how they run their businesses. It's far better today not to be a jack-of-all-trades but to be a firm with particular expertise in a number of significant areas."

Niche Based Upon Expertise

Gorfine, Schiller & Gardyn PA, in Owings Mills, Md., had much expertise in charitable work, not-for-profit organizations and unions. "Not-for-profit is a niche we were comfortable in," says W. James Schiller, CPA, the firm's co-founder and not-for-profit niche champion. "It was natural to pursue this niche since we had a lot of experience."

About 15% of Gorfine, Schiller & Gardyn PA's net revenue is generated from the not-for-profit niche. The niche grew by 30% in 2007 and the number of requests for proposals increased to nearly 30 in 2007 from a handful in 2004. The average client fee is more than $10,000. "Not-for-profit is the first we can call a niche," Schiller says. "We've targeted clients and started to produce results."

How is this being done? Beth Finglass, director of marketing, works with a not-for-profit team of eight to 10 members, who provide ideas and feedback for the marketing program. A variety of marketing tools are used, including participation in and teaching classes for the Maryland Association of Nonprofit Organizations, writing articles, sponsoring seminars, publishing a newsletter, hosting "meet and greets" with attorneys and bankers, limited advertising, and serving on not-for-profit boards of directors.

"You have to come up with a plan," Finglass says. "Figure out who you are targeting. What type of clients are you going after? How will you get in front of them?"

Gorfine, Schiller & Gardyn has redefined its not-for-profit target over the years, now focusing on those with $500,000 or more in total assets. "We've targeted the larger not-for-profits that need audit work," Schiller says. "There are many not-for-profit organizations and unions in the Baltimore area."

Developing Niches Through Mergers

You may identify potential niches for your firm but lack the champions. Hiring and/or merging industry specialists is an effective strategy. That is what happened seven years ago at Schenck Business Solutions in Appleton, Wis. Ken Zacharias, CPA, joined Schenck with the merger of Shinners Hucovski & Co.; and Mark Spaeth, CPA, MST, joined Schenck with the merger of Aronson Schroeder & Co. Zacharias and Spaeth are the co-team leaders of Schenck's real estate and construction niche.

"They spearheaded and set the example of how valuable it is to specialize," says Diane Roundy, MBA, director of business development. "Our shareholders now see the magic about specialization."

"Niche marketing is a great concept if done correctly," Zacharias says. "Our clients are getting larger and more complex, and tax laws are becoming more complex as well. It makes sense to have people that are very good technicians to handle those 'once-in-a-lifetime' transactions. Most clients come to my office because they have a life- or business-changing transaction that I can help them with. Then, they remain clients because they are treated well."

Zacharias began his real estate industry specialization by becoming an expert in tax-deferred exchanges. "I started receiving re-

quests to speak on the topic," he says. "Then I realized that I should get into other areas of real estate. Once you're considered an expert people presume that you know a lot more."

Schenck continues to formalize its real estate and construction niche. The team takes advantage of national training programs and networking with the instructors. The firm also continues to hire specialists to support the niche, for example, in cost-segregation analysis.

The niche has its own marketing plan and budget. The firm has sponsored a real estate forum for 14 years. "This event helps set the perception of our industry knowledge," says Roundy. Other marketing tools include speeches and a Web site. Ninety-five percent of new business comes from referrals.

Schenck's other niches include health care, government and manufacturing. "Strong leadership and branding, internally and externally, are very important to a niche marketing strategy," Roundy says. "You must have your employees talking about your brand."

Porter Keadle Moore LLP, in Atlanta, a past Capstone Marketing client, generates 75% of its revenue from its community banking niche. The practice started when the owner of an insurance company client asked if the firm was interested in auditing a bank that he owned. Tim Keadle, now a PKM partner, was recruited from Ernst & Young, and he brought a few banking clients with him. In 1987, the firm bought a local practice that had a banking niche. That brought the client base, and the firm gained its reputation.

"Great ideas come from listening to clients," says managing partner H. Phillip Moore Jr. "PKM provides nontraditional services to this niche. We built our SEC practice when our banking clients went public. Recently, we formed our IT Assurance Services Group to provide SAS 70 audits. Since many organizations in the banking industry require SAS 70 audits, we had the contact base to allow us to develop a reputation in this area. The results have exceeded our expectations."

What marketing tools does PKM use to promote its community banking niche? "If there is a community banking function we are there," Moore says. "We sponsor quarterly peer group meetings for newly formed banks and financial executives. These programs provide education, networking, financial benchmarking, guest speakers and CPE for community bank executives."

PKM also sponsors seminars, sometimes doing a joint venture with other CPA firms or law firms. PKM formed the Financial Institutions Forum, along with Powell Goldstein and the Bankers Bank, to educate community bankers. They also conduct training programs for internal auditors through the Community Bankers Association of Georgia.

"It was easy for us to build this niche because we are passionate about it, focused on it, and picked an industry that we enjoyed being a part of," Moore says. "For us, that means we are dealing with good folks, they have nice facilities, and it fit what we were looking for in our profession. It has served us very nicely."

Weaver & Tidwell LLP took advantage of its merger with Hoffman McBryde & Co. in 2000 to develop its health care niche. Both firms had many health care clients so it made sense to develop a formal niche.

Jill Eastman, marketing communications manager, joined Weaver & Tidwell in Fort Worth, Texas, in 2003 when the firm's health care niche was being formed. Between 2005 and 2006 the niche increased net revenue by 37%, which was 119% ahead of plan. How did this niche develop and grow?

"I conducted research on our current clients and the marketplace," Eastman says. "I also researched every opportunity we had regarding networking organizations. Every month, when the internal health care niche board met, we talked about advertising, speaking and networking opportunities. We presented a lot of our people as speakers.

"Each health care board member received a binder of marketing information including the marketing plan, calendar, events, pipeline and financial reports, public relations opportunities and CPE," Eastman says. "We also spent time building internal support and a reputation for the niche through partner presentations, our intranet and Web site."

Currently, Weaver & Tidwell uses a newsletter, association involvement, small-scale seminars, collateral materials and CPE to promote its health care niche.

Conclusion

Developing niche markets is an effective and profitable strategy for CPA firms of any size. Write a marketing plan, identify and support your niche champions, use a variety of marketing tools and activities, and implement consistently to create your own success stories. ❖

AICPA RESOURCES

JofA articles

- "First Form a Plan," Oct. 06, page 79
- "Get Your BV Niche Out There," Nov. 05, page 38
- "Niche Development Tips," Dec. 03, page 45

CPE

Marketing: Successful Strategies for CPA Firms, a CPE self-study course (#181831)

Publication

Marketing Advantage II: New Ideas on Getting and Keeping Clients (#090437)

For more information or to make a purchase, go to **www.cpa2biz.com** or call the Institute at 888-777-7077.

OTHER RESOURCES

Web sites

- CPA Marketing Tool Kit, **www.aicpa.org/cpamarketing**
- PCPS Firm Practice Center, **http://pcps.aicpa.org**

Recruiting (and Retaining)

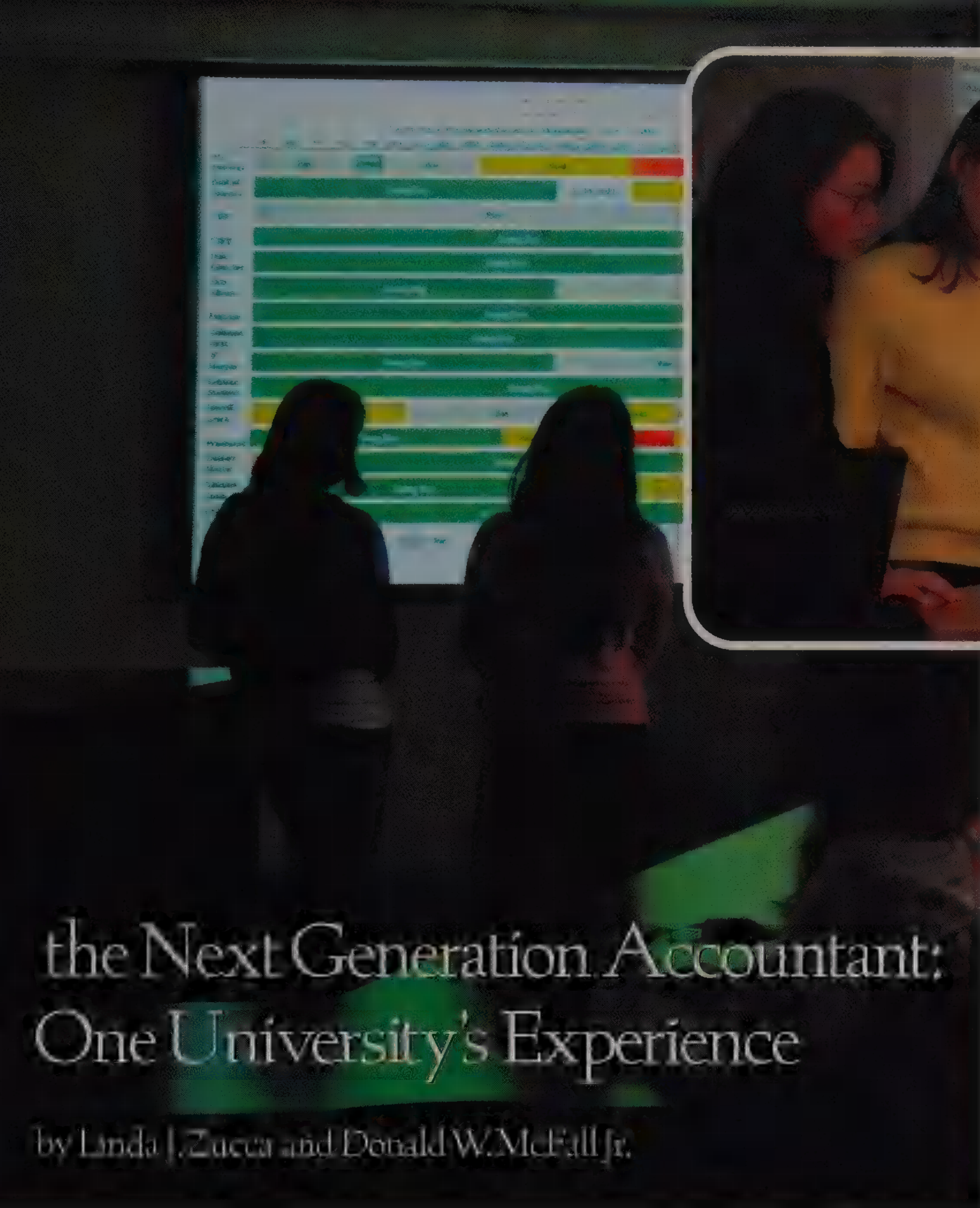
What attracts students to accounting? Is it the appeal of social and forensic accounting in a post-Enron world? Is it the allure of big money? Or is it simply supply and demand?

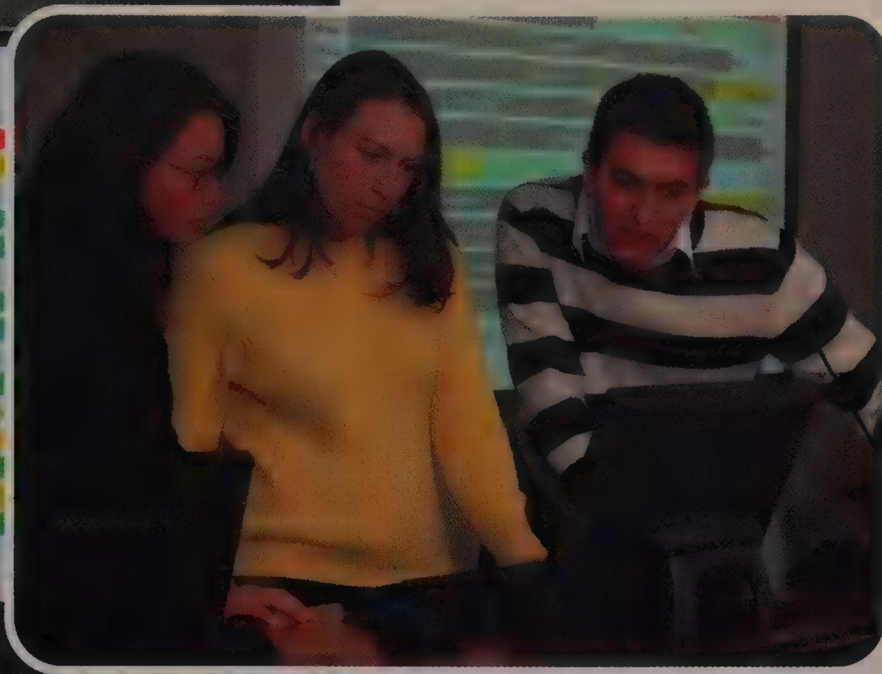
When it comes to attracting students to the accounting profession, faculty in university accounting departments face pressures from two sources: the accounting profession, which continues to demand more qualified accounting graduates; and university administrations, which want to increase enrollment. As a result, turning out well-qualified accounting majors in increasing numbers is of great importance to academia and the profession. More resources are being committed to recruiting accounting students and seeing them through to graduation.

This article examines the successes (and challenges) of the accounting faculty at Ohio's Kent State University as we explore ways to recruit and retain talented students in our accounting programs from freshman year to completion of a master's program. The financial constraints of higher education in our state have motivated us to develop solutions that are either cost-neutral or depend on outside funding to help attract larger numbers of well-qualified accounting majors.

Co-author Donald McFall, left, provides advice to junior accounting majors Olivia Ringler and Renee Pearce.

PHOTOS BY GARY HARWOOD/KENT STATE UNIVERSITY





Professor Weiwei Li, left, works with accounting students Olivia Ringler and Clayton Ward on a class project.

the Next Generation Accountant: One University's Experience

by Linda J. Zucca and Donald W. McFall Jr.

Supply and Demand for Qualified Accounting Graduates

According to AICPA President and CEO Barry Melancon the "pipeline" of qualified students is one of the four forces shaping the CPA profession today. Although interest in accounting careers has increased (the number of accounting degrees awarded increased 19% from 2000–2005), Melancon says the current demand for highly qualified students still exceeds supply, and this trend is expected to continue in the foreseeable future. He adds that about 73% of current AICPA members will reach or approach retirement age in the next 15 years.

On the supply side, the U.S. Census Bureau projects the number of college-age students (18- to 24-year-olds) will peak in 2010 and then decrease through at least 2020. In states including Ohio, Michigan, Pennsylvania and New York these declines are expected to continue beyond 2020. Faced with these numbers, universities are focusing on ways to increase student retention. Research has shown that the following student characteristics and experiences tend to increase retention:

- Higher academic performance and achievement.
- Social and intellectual integration into the university.
- Institutional commitment through residential life, classroom experiences, and faculty interaction.
- Early commitment to a major.
- Voluntary involvement in freshman orientation courses.

Our university has seen substantial growth in the number of pre-accounting (freshmen and sophomores) as well as accounting majors in recent years (see Exhibit 1). Although this trend is certainly welcome, we are still faced with the challenge of attracting the best-qualified students to accounting. And, once attracted

EXECUTIVE SUMMARY

- **The demand for qualified accounting graduates** continues to exceed supply; demand is expected to continue growing.
- **Universities are increasingly concerned** with retention of college students as they face projections of declining numbers of 18- to 24-year-olds.
- **A plan to recruit and retain** accounting majors throughout a five-year program is presented.
- **Key features include early involvement** in campus activities and with faculty, numerous opportunities for interactions with accounting professionals, and increased student-to-student mentoring.

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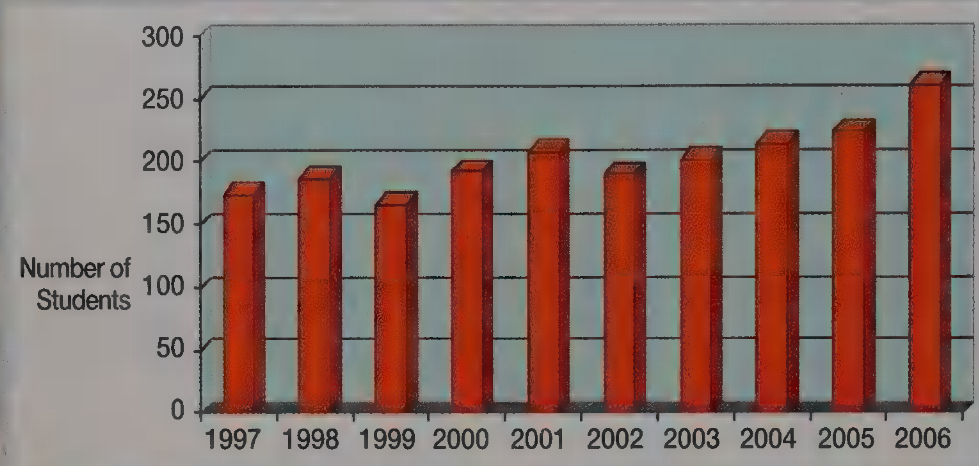
***Donald W. McFall Jr.**, CPA, MBA, is a lecturer in accounting at Kent State University. His e-mail address is dmcfall@kent.edu.*

Exhibit 1 Accounting Majors Over the Last Decade



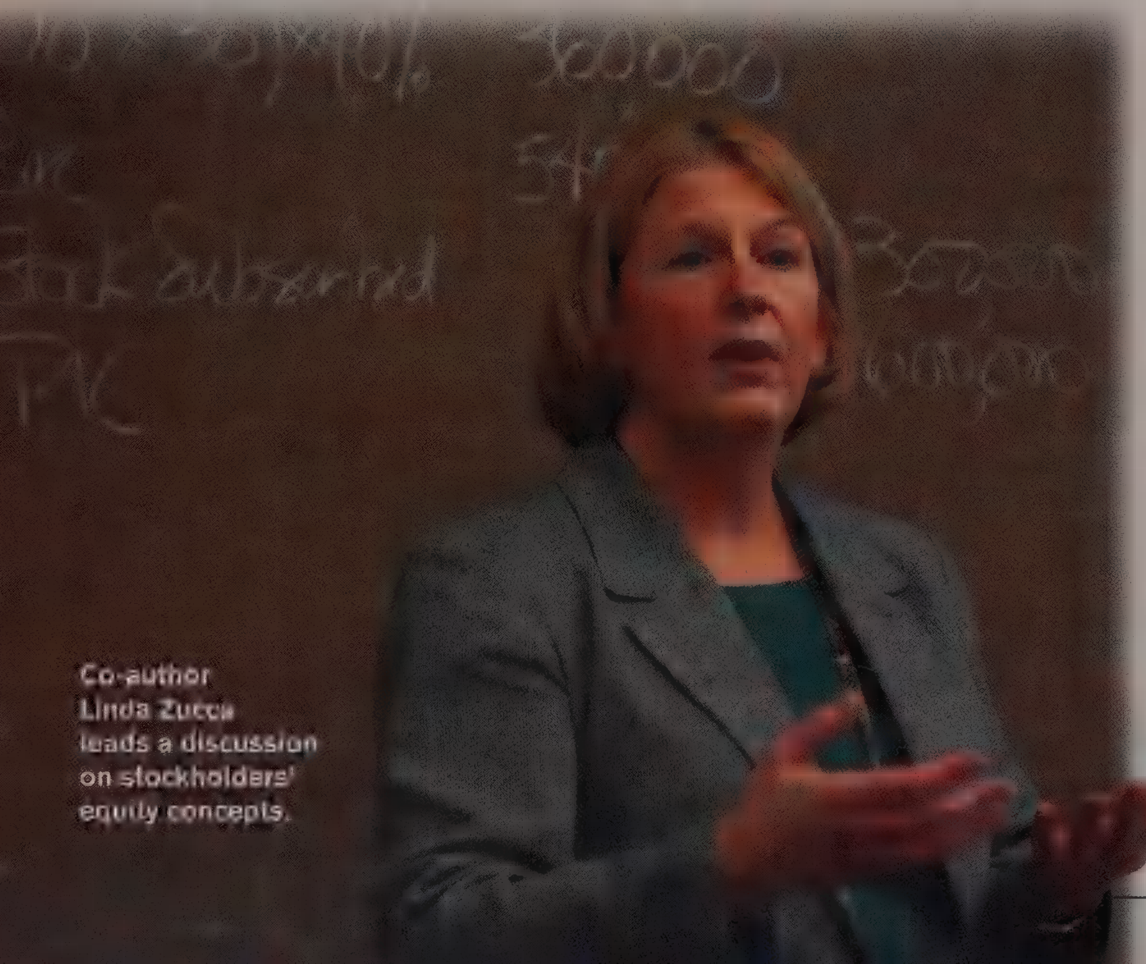
to the program, we need to retain them through the 150 semester credit hours required to take the CPA examination in Ohio. Traditional four-year undergraduate programs generally require approximately 120 semester credit hours, so the 150 credit hour requirement means that students will need to add another year to their educational experience (Ohio does not require a graduate degree) as we do not recommend students try to take the entire requirement in a four-year curriculum. A joint effort by the practice community and university accounting faculty may help solve this impending supply-and-demand problem.

Early Identification of Accounting and Business Majors

When our College of Business restructured the undergraduate business program about 10 years ago, we made a concerted effort to help our students become part of the college at the start of their academic career. Pre-business majors are required to take a substantial number of business courses during their first two years, before declaring a major. Our admissions advisers also encourage incoming freshmen to declare a "pre-major" in the College of Business. Although choosing a pre-major does not change course requirements, it does help the departments in the college project the number of students who might actually declare their majors as juniors.

Over the past six years, "pre-accounting" majors (freshmen and sophomores) have ranged from 10.5% to 15% of our total pre-business majors, while our declared majors (juniors and seniors) range from 5.9% to 8.6% of total declared business majors (see exhibits 1 and 2). There is a time lag in this data since pre-accounting majors cannot become accounting majors for one to two years. Likewise, incoming freshmen may not know enough about accounting to make an informed decision on their major and may not be motivated to change their pre-major even when they learn more about the program. However, the data show an interesting, and somewhat disconcerting, trend. We seem to be losing students who professed an interest in accounting as freshmen.

We are concerned about the potential accounting majors that we may be failing to serve. Faced with these trends (and spurred by a university-wide focus on student retention), we began looking for ways to attract and retain the most promising freshmen. One of our most effective resources came from the establishment of the Student Ambassador program at our university.



Co-author Linda Zucca leads a discussion on stockholders' equity concepts.

Student Ambassadors—Accounting Students Helping Other Students

The Student Ambassador program is sponsored by the Ohio Society of CPAs with financial support from the Ohio Society's Educational Foundation, Ohio public accounting firms, and individual CPAs.

This program designates outstanding current students to assist in student recruitment into the accounting pro-

fession using peer-to-peer networking.

These ambassadors receive funding for projects they undertake and a stipend for the hours they work. In 2005, we had our first student ambassador; during the 2006–2007 academic year, we had four student ambassadors. Over the past two years, they have undertaken many projects, including:

- Recruiting high school juniors and seniors to our university and accounting program.
- Making presentations about the CPA credential and profession to freshmen involved in learning communities and freshman interest groups.
- Organizing a "Careers in Accounting Day" for freshmen and sophomores.
- Arranging a mock interview day prior to on-campus internship interviews.

Our student ambassadors say the most effective and satisfying work is student-to-student interaction. Students are more comfortable asking student ambassadors about internship experiences and accounting career opportunities than asking their professors. In many cases, student ambassadors are considered a more credible source of information.

Freshman Year—A Sense of Community

In 2002, the College of Business instituted a learning community for freshmen in all pre-business majors. The program brings together students who are interested in learning opportunities and developing academic, social and professional relationships. As success with this learning community grew, our department was allowed to develop a similar community specifically designed for pre-accounting majors, called AFIG (Accounting Freshman Interest Group).

AFIG provides freshmen with information on accounting career paths as well as academic counseling while assisting them in the crucial transition from high school to college. Incoming freshmen are recruited to participate in AFIG during our Placement, Advising and Scheduling System Program held during the spring and summer; requirements include a minimum ACT score and submission of an acceptable essay. These first-year students take three classes each semester with other students in the program and are registered in a special University Orientation section.

The orientation class, taught by a full-time faculty member, is modified to provide information on the accounting profession and our academic accounting program. The students take field trips to public accounting firm offices and corporate sites, so they can network with local accounting professionals. In fall 2006, 80% of our inaugural AFIG class started their junior years as declared accounting majors.

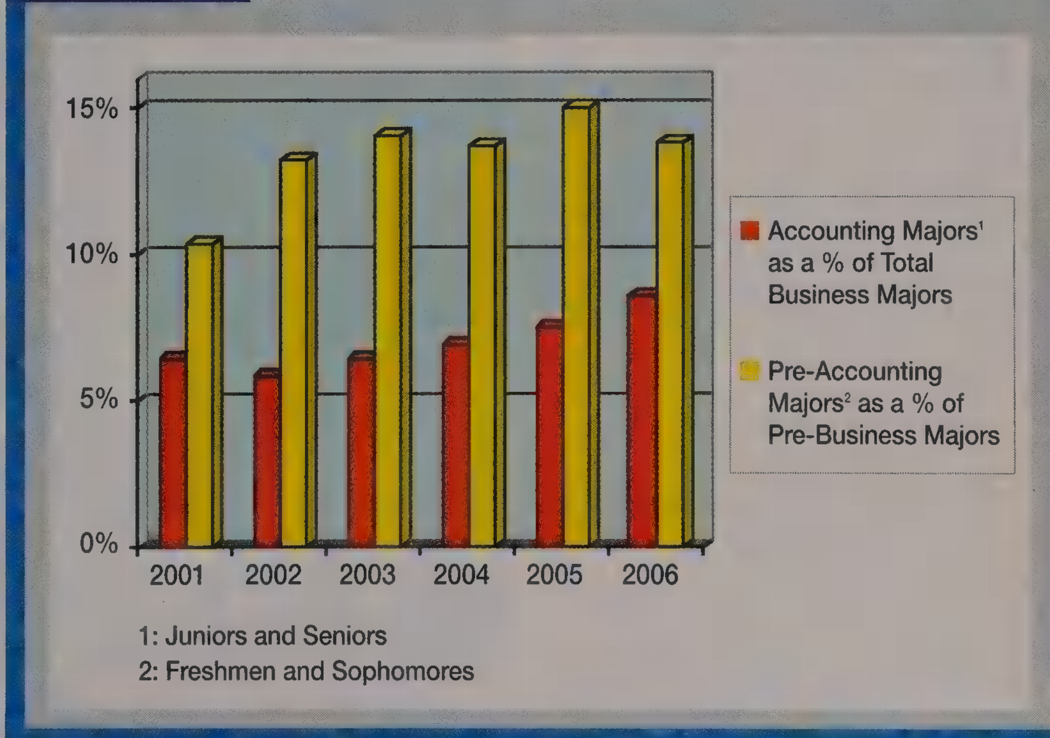
Sophomore Year—An Introduction to the Practice Community

Business students take two introductory accounting courses as sophomores. Many programs and majors across our campus (and outside of the College of Business) require students to take Financial Accounting, and we have found that many of our best accounting majors are recruited from outside the College of Business after taking this course. Unfortunately, with annual enrollments of up to 1,200 students in Financial Accounting and 800 in Managerial Accounting, and class sizes of up to 200 students per section, it is difficult to motivate high-quality students to consider an accounting major. As a result, we developed several activities throughout the year to provide information to sophomores who are exploring or finalizing their career choices. Our student ambassadors have been particularly helpful with these activities because of their ability to provide individual, student-to-student interaction.

We decided to focus on not just retaining students who had already identified themselves as pre-accounting majors but also recruiting the "best and brightest" students in sophomore-level courses who may not have expressed an interest in an accounting major. At the end of each semester, we sponsor a "Careers in Accounting Day," specially designed for the better students in these sophomore-level courses. Students maintaining at least a B average receive a special invitation; others are invited through a class announcement.

The three-hour event is held on a Friday, which is also a class day for Financial and Managerial Accounting. Students

Exhibit 2 Major Commitments



How Can CPAs Help Recruit College Students Into the Profession?

- Get involved in your local colleges and universities by volunteering as a guest speaker in the accounting classroom.
- Participate in job fairs targeted at freshmen and sophomores who are still making career choices.
- Ask local colleges and universities if you can become involved with freshman orientation classes as a guest speaker or mentor to college freshman who have an interest in an accounting career.
- Provide internships and shadowing opportunities to college students.

are invited to travel among four classrooms. Three of the classrooms have professional representatives from a particular area of accounting: Big Four public accounting firms; national and regional public accounting firms; and industry and governmental entities. Student leaders are in the fourth classroom. All are available for informal discussion in the first and third hour of the event. During the middle hour, lunch is served and presentations are made on student organizations and the undergraduate and graduate accounting programs. The event is coordinated and staffed by student ambassadors; out-of-pocket costs are covered by participating external organizations.

"Careers in Accounting Day" is popular with students and practitioners. Students receive information about accounting careers in a personal setting. They report that they enjoy the versatility of the program and the informal interaction with accounting practitioners; several indicated that they would change their major to accounting as a result of the program. Practitioners, mostly alumni, get a chance to return to campus and give back something to the university. They also have an opportunity to talk to sophomores, often a difficult group of students to pre-identify for recruiting purposes.

JUNIOR YEAR—INTERNSHIPS AND CAREER PLANNING

The third year is a time for students to clarify and intensify their commitment to the accounting major. Because students declare a major at the end of their sophomore year, the internship program is designed for juniors, seniors and graduate students. Early each fall, accounting majors are recruited into the internship program, culminating in on-campus interviews by more than 20 employers. Eligibility is determined by class standing and accounting GPA. In fall 2006, 85 students participated in the interview

process. Before interviews begin, students meet prospective employers at our annual "Get Acquainted With Accountants Night" and also have the opportunity to participate in mock interviews with professional accounting recruiters.

The internship is the most powerful retention tool available for our students, and we strongly encourage participation. For most students, this positive experience provides intensity and direction for the remainder of their academic program. One student said about the program:

> It is…amazing to me how much I learned in such a short period of time. I feel that I can call myself an accountant now. I am so happy that I chose to go into public accounting; it is an exciting field where things are constantly changing. I am lucky to have a job at a place I love waiting for me when I graduate. This whole internship has been an amazing learning experience that I would never take back for anything in the world.

For a few students, however, the internship confirms the doubts they had about an accounting career and results in a change of major, often outside the College of Business. Perhaps this is the most valuable outcome of the internship experience since it allows a student to find the right career while still in the middle of an undergraduate program.

In the second semester of our students' junior year, our MSA coordinator gives students information on career planning and the master's program. An accelerated track in our curriculum allows better students to combine some of their undergraduate and graduate coursework; admission to the accelerated program is based on overall and accounting GPA and their GMAT exam score.

One of our challenges is to encourage students to pursue the CPA exam as soon as possible after graduation.

Senior Year and Graduate School—Career Counseling and "Giving Back"

By senior year, many of our students have completed an internship and committed to full-time employment, commencing after completion of their 150-hour requirement. Some have already been admitted to the graduate program and are taking graduate classes while completing their undergraduate degree. We have begun to emphasize managerial accounting careers in our junior-level Cost Accounting course and to encourage students to begin taking the CMA examination as seniors or graduate students. In fall 2006, we took a group of students to the IMA National Student Leadership Conference and plan to encourage participation in local IMA student activities.

This is also the point in their academic careers at which many of our better students focus on mentoring underclass students on career opportunities in accounting. All of our student ambassadors are either seniors or MSA students. In addition, most of the officers of our student organizations are seniors or graduate students. As they develop programming for the student organizations, they use experiences and contacts acquired during internships. These students design service projects (such as "Careers in Accounting Day" and mock interviews) to help younger students understand the opportunities available in the accounting profession.

Accounting graduate students Bronwyn Salo, left, and Colby Schroath consider taxation issues with Professor Mark Altieri.

AICPA RESOURCES

***JofA* articles**

- "The Red Carpet Treatment," Aug. 07, page 36
- "Understanding the Best and Brightest," Nov. 06, page 41
- "Tips to Win Campus Friends," Aug. 06, page 71
- "Teaching for the Love of It," June 06, page 30
- "Recruiting Made Easy," May 06, page 31
- "The Practitioner-Professor Link," June 05, page 77

Publication

The PCPS Top Talent Study: Gaining a Strategic Advantage in Recruiting and Retention (#018202PDF, download)

For more information or to make a purchase, go to **www.cpa2biz.com** or call the Institute at 888-777-7077.

One of our challenges is to encourage our students to pursue the CPA examination as soon as possible after graduation. Unfortunately, it is difficult to track the experience of all of our students on the CPA examination after graduation, but we are encouraged that most of our top students are able to pass the exam in the first 18-month window. We are currently working on better ways to track their progress.

SUMMARY

Recruitment and retention are buzzwords in the academic community and they apply particularly well to the decisions facing accounting majors and the accounting profession. The current balance of supply and demand will result in increased interest in accounting on the part of incoming freshmen. Partnering with accounting practitioners has provided increased opportunities for our students and increased access for employers in the recruiting process. Our challenge is not just to accept all students with an interest in accounting, but to focus on recruiting and retaining the *brightest*—to enhance the accounting profession for the next generation. ❖

"Success in Two" for the CPA Exam

At LarsonAllen LLP, our goal is to get employees started on the exam within one year of their full-time hire date, and then to pass the exam by their second anniversary with the firm–hence the name of the program "Success in Two."

Here's how we do it:

- If employees register for the Becker CPA Review by their one-year anniversary, LarsonAllen pays most of the cost, while the employee invests a small amount of the price.
- If the employee passes the exam by his or her second anniversary, we reimburse the employee's investment in Becker and one-half of the application and testing fees for one round of the exam.

The plan encourages employees to set a timeline for completing the exam, and the financial benefit encourages employees to prepare and sit for the exam only once.

We currently have 204 eligible CPA candidates in our firm. Of those, 152 are actively sitting for the CPA exam (74%). Of the 52 who are not sitting, 63% began employment with us within the last year (they're still short of their one-year anniversary date deadline to start the Success in Two program).

Over time, we've been able to reduce the number of experienced employees (those who have been with us one year or longer) who have not started the exam from 14% of our testing population to 6%.

Mentoring

In the summer of 2006, we placed CPA exam coordinators in each office (or for very large offices like our Minneapolis location, a coordinator for an industry or service group). We asked office principals-in-charge (PICs) to assign someone as exam coordinator who:

- Is a CPA,
- Has the ability to help employees work out scheduling conflicts, and
- Can encourage and motivate employees to get the exam done.

Exhibit 3 shows the results we've seen in our overall pass rates since we instituted exam coordinators–the average pass rate has improved from 41% to 60% in a little more than a year.

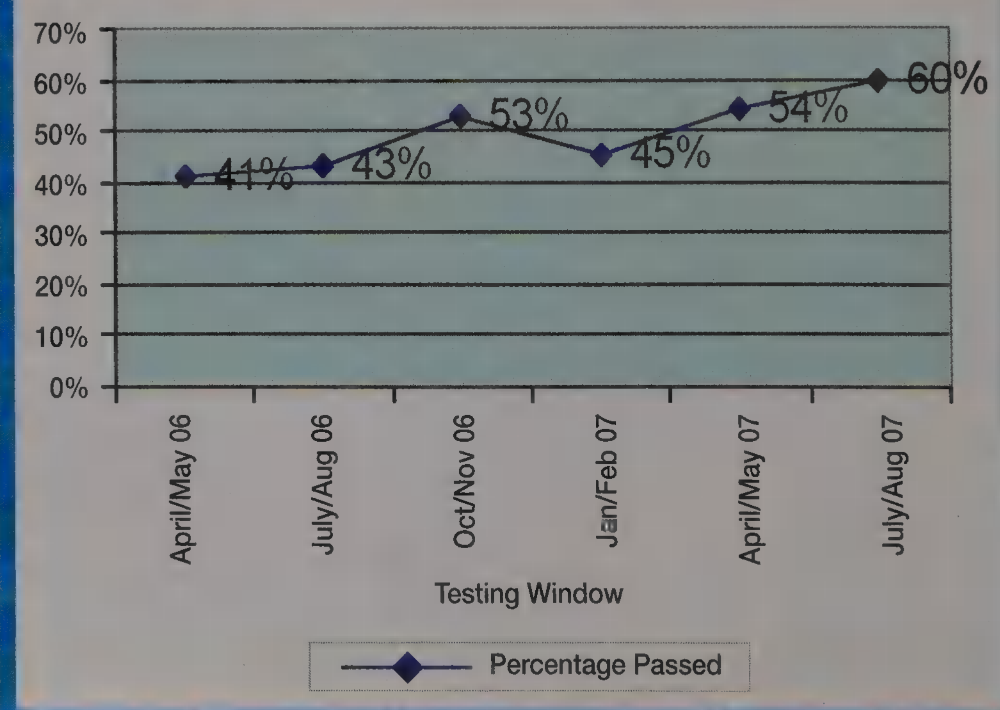
Success in Two Exam Plan Packet

In addition to exam coordinators, we provide a job aid who coaches employees on:

- Planning their exam schedule,
- Who they should talk to in order to make sure their plan is reasonable,
- How much time they should schedule for exam study,
- Which review method would be best for them, and
- Timing issues that can trip them up when taking the exam (NTS expirations, 18-month window, "dark" months for testing, etc.).

Beth Spencer *is the manager of licensure & CPE, A&A Quality Group, at LarsonAllen LLP. She can be reached at espencer@larsonallen.com.*

Exhibit 3 Overall LarsonAllen Pass Rate by Exam Testing Window



On Equal Terms

Rep. Rick Boucher tells why patents on tax planning methods run counter to public policy.

Rep. Rick Boucher, D-Va. (9th District), has been at the forefront of efforts to stop patents on tax planning methods. With a fellow Virginian from across the aisle, Rep. Bob Goodlatte, R-Va., and Rep. Steve Chabot, R-Ohio, Boucher introduced HR 2365, a free-standing bill, to limit damages for infringements on patents for tax planning methods.

In May last year, Boucher introduced a measure to ban tax planning method patents, as an amendment to the Patent Reform Act, HR 1908, a bill to reform the patent system generally. The amendment was passed by the House Judiciary Committee on a voice vote, and the Patent Reform Act, with the tax patent ban, passed in the House in September by a vote of 220–175. In November, a companion patent reform bill was introduced in the Senate. The AICPA has been among groups and individuals who have lobbied against patents for tax planning methods (see "Washington Report," *JofA*, June 07, page 26).

Recently, the *JofA* spoke with Boucher at his House offices in Washington about these patents.

JofA: *What is the main reason for your belief that the U.S. Patent and Trademark Office should not issue patents for tax planning methods?*

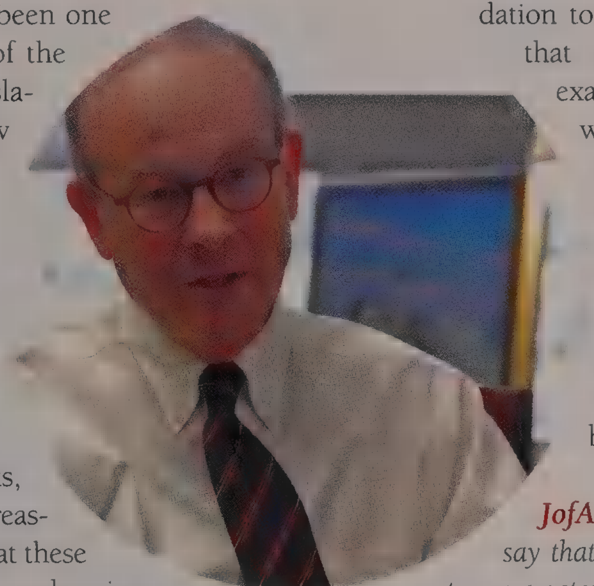
Boucher: I think these patents are fundamentally contrary to sound public policy because they vest in a single person or company control over a process that taxpayers generally can utilize in order to pay their taxes efficiently. The patenting of tax planning methods runs contrary to our long-held belief that people should be empowered to pay their taxes on equal terms, using whatever strategies they themselves perceive or their tax practitioners recommend.

To permit patents to be held for the specific ways in which taxes are paid is

simply a trap for the unwary practitioner. Some of the smaller accountants, for example, do not have a habit of keeping track of patent law. They understand the Tax Code very well. They know how to advise their clients in a superb fashion. But they are not watching day to day for the award of particular patents that might interfere with their offering the best advice that they can. And so it is entirely possible that an accountant would not be aware of a particular patent that has been issued. Through his own cleverness, he might devise a strategy that would infringe upon that patent without realizing that he's doing it. And then not only would he or, potentially, his client be responsible for basic infringement, but if it seemed to be intentional in some way, then multiple damages could be awarded. And this is all contrary to the basic notion that people should not have to pay a license fee in order to pay their taxes.

JofA: *Why is this issue personally important to you?*

Boucher: I have served on the House Judiciary Committee now for 25 years, and I have been one of the advocates of the patent reform legislation that we're now putting forward. As it became apparent to me over the last several years that there has been a proliferation of the award of business method patents, I have become increasingly concerned that these patents generally undermine the principal purpose of the patent laws, which is to promote innovation and to stimulate creativity. Business method patents tend to wall off entire areas of commerce in a way that inhibits competition and therefore lessens creativity and innovation. From my perspective, the most virulent form of business method patent that has emerged to date are the roughly 60 patents that have been issued for tax planning methods, and we now have more than 106 applications for those patents pending in the Patent Office.



Not only was I pleased that our amendment to eliminate prospectively the award of tax planning method patents was approved, but I am now urging the Patent Office to re-examine the business method patents that have been issued so far with regard to tax planning methods to determine whether in the opinion of the Patent Office those patents were properly issued.

JofA: *How have you been encouraging the Patent Office to do this, and have you received any response?*

Boucher: I have not received any response yet; I simply made the recommendation to the Patent Office that these patents be examined once again with the goal of giving them very careful scrutiny and perhaps invalidate those that they found not to have been properly issued to begin with.

JofA: *Someone might say that people who choose to use a patented strategy, if they do know about it, that's their choice to do so, or they could avoid that planning method.*

Boucher: Some planning methods are clearly so superior to others that they would be preferential to all with the freedom to choose to adopt them. And if employing such a clearly preferential method only comes at a high price, in terms of a license fee that has to be paid to the patent holder, there will be those who choose to avoid that method and use a less beneficial method of paying taxes. The cost of using the less beneficial method, in terms of greater tax liability, may be less than the cost of a license fee for using the more beneficial method.

"The government intends that all people be able to pay their taxes on equal terms."

The government intends that all people be able to pay their taxes on equal terms and that the best method for utilizing the law that Congress wrote and intends for the public to utilize be freely available for the choice of all taxpayers, not just those who choose to pay a license fee to some person who holds a patent.

JofA: *What needs to happen for the Senate to move patent reform forward?*

Boucher: We are anticipating that the Senate will act favorably before the end of this year and that a patent reform bill will reach the president's desk before this Congress adjourns. I am anticipating that when that happens, our provision with regard to tax patents will be a part of that measure. The bill is in the Senate Judiciary Committee. Sen. [Patrick] Leahy [D-Vt.], who chairs that committee, is a strong proponent of the patent reform effort overall. I am not sure that he's announced a position with regard to the patentability of tax planning methods, but I would anticipate, given the broad base of support we had for our amendment in the House—where it passed by voice vote in committee and was not contested on the floor—that we would also have similarly broad support in the Senate. I'm not aware of senators having raised questions or opposition to this.

JofA: *Do you think the president would be likely to sign it?*

"(Patents for tax planning methods) are so fundamentally contrary to public policy as to merit complete eradication at this point."

Boucher: I think that he would. The overall contention with regard to patent reform is a bit of a tug of war between the technology community on the one hand and the pharmaceutical community on the other, and it remains to be seen how that particular struggle will play out in the Senate. My prediction is the Senate will pass a bill not very dissimilar to what the House has passed. That would make a conference between the two bills relatively easy.

I'm predicting the president will sign it into law because it does so many things that I think people across the board believe are necessary to improve patent quality. Permitting, for example, more information about "prior art" to reach the patent examiner. Permitting a review within the Patent Office before the patent is actually issued, through a formal process to determine whether or not that patent should be awarded. That's a procedure that's absent today, and I think it would be extraordinarily helpful in improving patent quality.

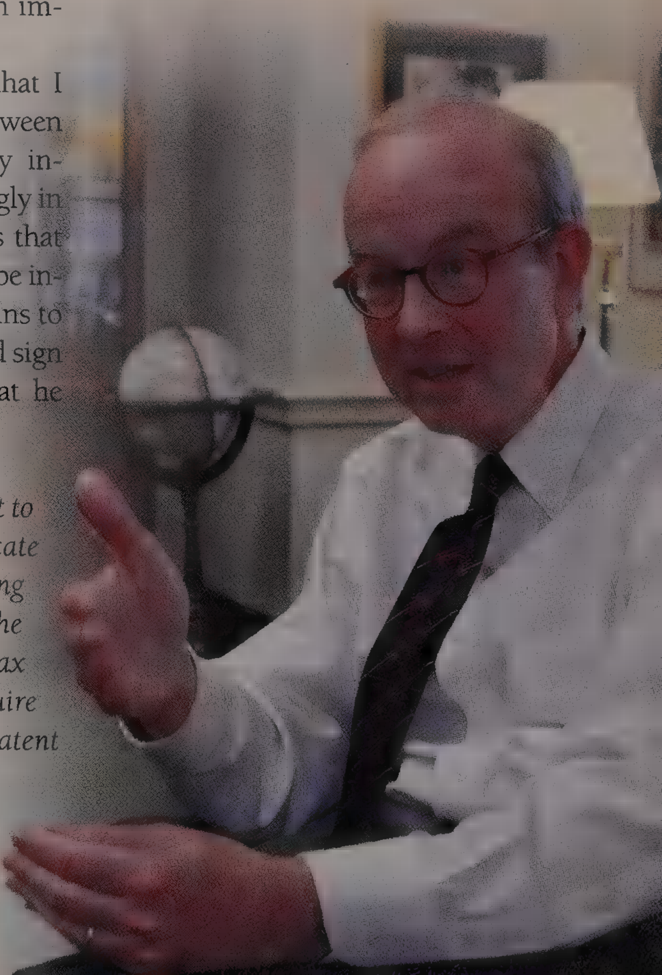
There are parts of this reform that I think, without regard to the tussle between the pharmaceutical and technology industries, would be found to be strongly in the public interest, and my sense is that based on those, the president would be inclined to sign the bill. But that remains to be seen. I think the chances he would sign it greatly outweigh the chances that he would veto it.

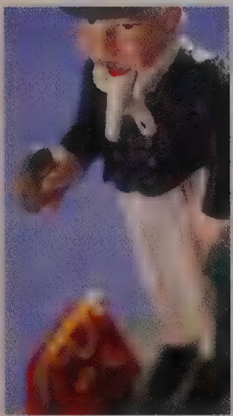
JofA: *In her most recent annual report to Congress, National Taxpayer Advocate Nina Olson identified tax planning patents as a top legislative priority. She called on Congress to eliminate tax patents, bar their enforcement or require the Patent Office to refer all tax patent applications to the IRS to identify abusive strategies that should not be eligible for patenting. The latter option would be kind of a middle way. Would that be acceptable?*

Boucher: No, I think we should simply eliminate the potential for tax planning methods to be patented in the future. They are so fundamentally contrary to public policy as to merit complete eradication at this point.

JofA: *Have you heard from your constituents or others who have personal experience with these business method patents, frustrations with them?*

Boucher: I have heard from a number of accountants and tax lawyers with whom I am well acquainted, both in my district and other places, who have applauded the amendment and have said that there never should have been awards of patents for tax planning methods, and they are very pleased to see Congress act affirmatively in order to stop the future award of these patents. ❖





TAX PRACTICE CORNER

FLPs That Flop

In several recent cases, the IRS successfully challenged attempts to exclude from taxable estates assets transferred to family limited partnerships (FLPs, or "flips") in which a decedent had retained the right to enjoy the property or income from it.

Besides reducing estate taxes, purposes of FLPs include liability protection and asset management. Usually, a parent transfers assets to a FLP in return for ownership of interests. The parent then gifts interests in the FLP to one or more heirs, discounting the gifts' values to reflect a lack of marketability and their minority interest. But under IRC § 2036(a), if the transfer is for less than full and adequate consideration in a bona fide sale and the decedent has implicitly or explicitly retained possession or enjoyment of the transferred property or the right to income from it, the property's value is included in the estate.

In *Estate of Concetta H. Rector et al. v. Commissioner*, TC Memo 2007-367, the taxpayer petitioned the Tax Court to redetermine an IRS-assessed estate tax deficiency of more than $1.6 million and accuracy-related penalty of nearly $93,000. The estate unsuccessfully argued that the decedent had not retained enjoyment of FLP assets or, alternately, that her transfer of assets to the FLP was a bona fide sale.

SALE NOT IN GOOD FAITH

Treas. Reg. § 20.2043-1(a) provides that a bona fide sale must have been made in good faith, which the court noted previous cases have interpreted as reflecting a legitimate and significant nontax business purpose. The taxpayer, however, had no business plan, no independent counsel, no financial statements or annual accounting, no board meetings and no other businesslike activity. The court also noted that the FLP was not even funded for the first three months after its formation.

The estate claimed that it formed the FLP to save on estate taxes, to diversify assets and to protect assets from creditors. The IRS was able to show that no diversification was ever made and that the ownership and management of the assets didn't change after the transfer. Additionally, because the transfer awarded the decedent a partial general partner interest, she effectively received no protection from creditors. This left estate tax savings as the only remaining purpose for the FLP, which the court determined was not a nontax business purpose.

GRANTOR RETAINED RIGHTS

As for a retained enjoyment of property or its income, the Tax Court found that the taxpayer had transferred substantially all her assets into the FLP. Because she primarily used the assets for her personal benefit and paid personal expenses directly from the FLP, the Tax Court said that she personally retained possession of them.

The Tax Court frequently cited *Estate of Bigelow v. Commissioner* (100 AFTR2d 2007-6016), as well as TC Memo 2006-115 (*Rosen*), TC Memo 2003-145 (*Strangi*) and other cases.

Bigelow, decided three months earlier by the Ninth Circuit, involved similar facts. Again, the FLP paid the decedent's bills, FLP property secured personal debt, and most assets were transferred by the decedent to the FLP. In both *Bigelow* and *Rector*, the personal expenses of the grantors exceeded their retained assets, and they had to use the income from the FLP to survive, proving to the courts that no bona fide transfer had occurred. In neither case was a valid business purpose proved nor any businesslike proceedings followed.

TIPS FOR FLPs

Here, then, are some steps for FLPs to take or avoid to help protect themselves from IRS challenge:

- Document a valid nontax business purpose for the transfer, such as liability protection or diversification, and follow through on it.
- Do not provide the grantor with a general partnership interest.
- Hold annual discussions with other partners on investment performance and other business matters of the FLP.
- Disclose financial information yearly to all partners in a timely manner.
- Treat the FLP as a separate entity from the grantor by maintaining separate checking accounts, making sure assets are properly titled, and not commingling funds.
- Obtain outside counsel to establish and monitor compliance with the FLP document and state law.
- Make sure that the grantor retains enough personal assets to live on, without using FLP assets or income to pay for basic needs.

*By **Bob Jennings**, CPA, CFP, CITP, president of Jennings Advisory Group LLC of Clarksville, Ind., and a frequent writer and CPE speaker on tax topics. His e-mail address is taxspeaker@gmail.com.*

Iso Certified

TAX MATTERS

GAIN AND LOSS, PARTNERSHIPS

STEP RIGHT UP

The Tax Court upheld as having economic substance a partnership's nearly $12 million distribution of notes to redeem partners' interests in real estate on which the partnership claimed a step-up in basis. The IRS had denied the partners' resulting nonrecognition of gain on grounds that the distribution consisted of either cash or marketable securities and that the partnership was not entitled to step up its basis.

The partnership, Countryside Limited Partnership, was owned by Arthur M. Winn, Lawrence H. Curtis and others. Countryside owned a 448-unit residential property in New Hampshire that it planned to sell at a gain. Before the sale, Countryside and a limited liability corporation it indirectly owned borrowed a total of $11.9 million at the London Interbank Offered Rate (LIBOR) plus 175 basis points. The LLC used the cash to purchase four privately issued notes paying interest at LIBOR minus 55 basis points. The partnership distributed its interest in another LLC indirectly holding the notes to redeem the partnership interests of Winn and Curtis. The partnership made a section 754 election and increased the basis of the real estate, eliminating the gain on its sale. The Service concluded, however, in a final partnership administrative adjustment that the distribution created taxable gain to Winn and Curtis. Winn sought a partial summary judgment on that issue, which the Tax Court granted and issued a memorandum opinion.

Section 731 generally provides for nonrecognition of gain or loss on partnership distributions that don't exceed a partner's outside basis. One method previously used to avoid excess gain was to purchase and distribute marketable securities instead of cash. In response, Congress enacted section 731(c), which treats marketable securities as cash for purposes of section 731.

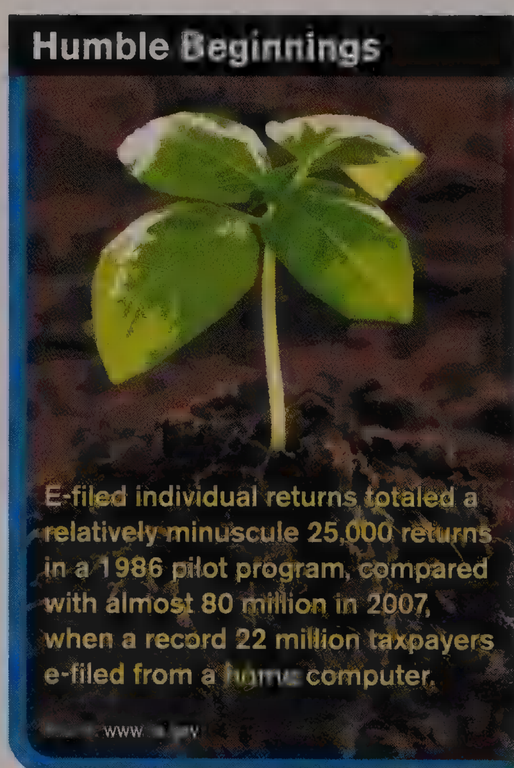
The government argued that the notes were marketable. To be marketable securities, notes must either be traded on an exchange or subject to an arrangement to convert them into marketable securities. These notes were not traded on an exchange, and the fact that their terms could be modified wasn't sufficient to constitute an arrangement for conversion to marketability, the court said.

The government secondarily argued that the distribution lacked economic substance. It stated that the interest expense on the borrowed funds would always exceed the interest income on the notes purchased with those funds. But the Tax Court said the Service was evaluating the wrong transaction. The distribution, not the loan, was at issue. Since the distribution of the notes terminated the partners' interests in the partnership and the real estate, it had economic substance and could not be disregarded.

In similar cases, courts have ruled against taxpayers (see, for example, *ACM Partnership v. Commissioner*, TC Memo 1997-115, on contingent installment sales). This case awaits a final decision, and it was unclear whether the IRS will file an appeal, which would be to the District of Columbia Circuit.

■ *Countryside Limited Partnership v. Commissioner*, TC Memo 2008-3

Prepared by ***Edward J. Schnee****, CPA, Ph.D., Hugh Culverhouse Professor of Accountancy and director, MTA program, Culverhouse School of Accountancy, University of Alabama, Tuscaloosa.*



GAIN AND LOSS, HOME SALE EXCLUSION

THIS SOLD HOUSE

The Tax Court recently held that a couple could exclude gain from the sale of one of their two residences, since during the five-year period preceding the home's sale, it was used as the couple's principal residence for the requisite two-year period. The taxpayers were not allowed to exclude the gain from the sale of an adjacent lot, however, because that property was titled to a family partnership.

Married taxpayers are permitted to exclude up to $500,000 of gain from the sale of a home if, during the five years preceding the sale, the residence was owned by either spouse and used by both spouses as their principal residence for periods totaling at least two years. Generally, only one sale every two years can qualify for the exclusion. Under Treas. Reg. § 1.121-1(b)(2), other factors used to determine a taxpayer's principal residence are where the taxpayer works and banks; where the taxpayer's family lives; the location of the taxpayer's religious and recreational organizations; and the mailing address listed on the taxpayer's tax returns, driver's license, voter and driver's registration, bills and correspondence. The gain from the sale of land adjacent to a principal resi-

dence that is owned by a taxpayer and used as part of that residence can also be excluded if the sale occurs within two years before or after the sale of the residence and all other section 121 requirements have been satisfied.

Dr. J. Ramsay Farah and his wife, Elizabeth, lived in Hagerstown, Md., where Dr. Farah operated a medical practice. In 1989 they purchased a vacation home in Berlin, Md., ultimately to be used as a retirement home. In 1991, a family partnership in which the Farahs each owned a 35% interest bought a 2.39-acre lot next to the Berlin home that they used as an additional yard. When the couple's daughter attended college near Berlin in 1997, Mrs. Farah moved to the Berlin residence.

Meanwhile, Dr. Farah stayed largely on the road. He sold his medical practice in Hagerstown in 1998 and from May 1998 to May 2001 worked three days a week in Baltimore, 75 miles from Hagerstown and 138 miles from Berlin. He also traveled to clinics and medical facilities along the East Coast from Virginia to Maine. During that time, he lived at the Berlin home on nonworkdays and weekends and returned to the Hagerstown home only about once a month.

In early 2001, after Mrs. Farah was diagnosed with cancer, the couple decided to move back to their Hagerstown home and sell the Berlin property. They listed it for sale that March and sold it in October for $1.3 million.

The IRS argued that the Hagerstown home was Dr. Farah's principal residence from June 1998 to May 2001, since it was closest to his Baltimore work location and the Hagerstown address was used as a mailing address for tax returns, driver's licenses and vehicle and voter registrations.

The court was not persuaded. It instead held the Berlin home was Dr. Farah's principal residence during that period, accepting his testimony that he had spent a greater amount of time there and that he used the Hagerstown mailing address only to provide a stable appearance for his business and professional activities.

The court did reject the Farahs' contention that since they owned the adjacent lot in substance, the gain from its sale should also be excluded. The court held that the Farahs had the freedom to title the property under the partnership's name but must also accept the consequences of that choice. They had 10 years to alter the form of ownership but chose not to and named the partnership as the owner when listing the property with a real estate agent.

The case illustrates how a dwelling originally held as a vacation or retirement home may, under the proper circumstances, qualify as a primary residence eligible for the gain exclusion of section 121, despite a homeowner's distant work location and frequent absences.

■ *J. Ramsay and Elizabeth Farah v. Commissioner*, TC Memo 2007-369

Prepared by ***Charles J. Reichert****, CPA, professor of accounting, University of Wisconsin–Superior.*

GAIN AND LOSS

LIKE A GOOD NEIGHBOR

The Ninth Circuit has affirmed a district court and held that termination payments received by a retiring insurance agent were not capital gain but were taxable as ordinary income. The court thus joins the Seventh Circuit in so ruling on similar facts. See *Warren L. Baker Jr. v. Commissioner*, 92 AFTR2d 2003-5640.

Charles Trantina retired after working 38 years as a State Farm agent in Phoenix. Under his agency's contract, the insurer provided forms, manuals and records and assisted Trantina with some advertising costs. In return, the agency solicited and serviced insurance policies, which also belonged to State Farm. State Farm paid Trantina commissions and, upon his retirement and the dissolution of the agency's corporation, termination payments.

Trantina originally reported these termination payments as ordinary income on his individual tax return but later amended his return to recharacterize them as long-term capital gain. He claimed they resulted from the sale or exchange of a capital asset—the agreement with State Farm—that was held longer than one year. The IRS denied the refund, and Trantina sued in district court. The court granted summary judgment for the IRS, finding that the agreement was not a capital asset and that no exchange or sale of it had occurred. Trantina appealed.

The Ninth Circuit reasoned that to realize a capital gain, there must be ownership of a capital asset. However, under the terms of the agreement with State Farm, Trantina had no property that could be sold or exchanged. All manuals, forms, records and policies were the property of State Farm. Trantina countered that the agreement itself was a capital asset that he exchanged with State Farm for the termination payments. The court responded that the termination payments were made *pursuant to*, not in exchange for, the agreement. Trantina was not entitled to the termination payments unless he complied with two requirements—that he return all State Farm property and that he not compete with State Farm for 12 months.

Taxpayers will not have success in achieving capital gain treatment unless the asset in question meets the definition of a capital asset. Under IRC § 1222(3), to classify income as a long-term capital gain, the payments must arise from the sale or exchange of a capital asset held longer than one year and must be given in consideration of this sale or exchange.

■ *Charles E. Trantina v. U.S.*, 101 AFTR2d 2008-443

Prepared by ***Karen M. Cooley****, CPA, MBA, instructor of accounting, and* ***Darlene Pulliam****, CPA, Ph.D., McCray Professor of Business and professor of accounting, both of the College of Business, West Texas A&M University, Canyon, Texas.*

INCOME AND DEDUCTIONS, INTERNATIONAL

IRS CAN'T SHAKE YARDSTICK AT TAX TREATY

The Court of Appeals for the Federal Circuit ruled a U.K. bank was entitled to

a $65 million refund because the IRS applied a regulation that increased the institution's income by $155 million in violation of the U.S.-U.K. tax treaty of 1975.

In the tax years 1981–1987, National Westminster Bank PLC (NatWest), a U.K. corporation engaged in international banking activities, conducted wholesale banking operations in the U.S. through six permanently established branch locations (the "U.S. Branch"). On its U.S. federal income tax returns for the years at issue, NatWest claimed deductions for accrued interest expenses as recorded on the books of the U.S. Branch.

The IRS used the formula of Treas. Reg. § 1.882-5 to recompute the U.S. Branch's interest expense deduction. The formula excludes consideration of interbranch transactions for the determination of assets, liabilities and interest expenses under section 1.882-5(a)(5). The formula also imputed or estimated the amount of capital held by the U.S. Branch based on either a fixed ratio or the ratio of NatWest's average total worldwide liabilities to average total worldwide assets under section 1.882-5(b)(2).

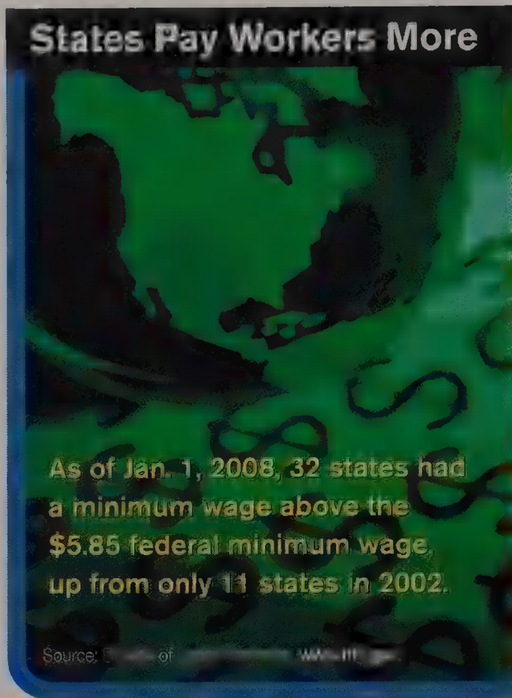
At the trial court level, the Court of Federal Claims granted summary judgment for NatWest, ruling that the application of section 1.882-5 violated the 1975 U.S.-U.K. tax treaty, *Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains*. The Federal Circuit upheld the ruling that NatWest was entitled to the refund of $65,723,053 plus interest.

The IRS argued that it was permitted to attribute capital to the U.S. Branch based on regulatory and marketplace capital requirements that apply to U.S. bank corporations, called the "corporate yardstick." NatWest said the 1975 treaty did not allow the imputation of capital to the U.S. Branch based on capital requirements to which it was not subject. The appeals court agreed with NatWest that the "separate enterprise" principle of Article 7, paragraph 2 of the treaty barred the IRS from disregarding interbranch transactions when computing the interest expense properly deductible by a permanent establishment and from imputing capital on a basis other than an as-necessary adjustment of the U.S. Branch's books to reflect actually allotted capital.

The appeals court also noted that this interpretation was in accord with a U.K. ruling that caused the U.K. to abandon a formula imposed by its tax authorities because it violated the treaty's separate-enterprise principle.

■ *National Westminster Bank v. U.S.*, 101 AFTR2d 2008-490

Prepared by JofA *staff member* ***Jeffrey Gilman****, Esq.*



GIFTS AND ESTATES, CHARITABLE DEDUCTIONS

SPLIT-INTEREST PROHIBITION UPHELD

The Third Circuit Court of Appeals joined other jurisdictions in affirming IRC § 2055(e)'s prohibition of charitable deductions from an estate for transfers of interests in trust property that are not definitely divided between charitable and noncharitable beneficiaries, even where the arrangement shows little likelihood of being abusive in the way the subsection was enacted to prevent.

In its June 2007 opinion, the Third Circuit upheld the ruling of the District Court for the Western District of Pennsylvania and noted similar facts and holdings previously by the Fifth Circuit (*Estate of Johnson v. U.S.*, 68 AFTR2d 91-6049); the Tax Court (*Estate of Edgar v. Commissioner*, 74 TC 983); and a Nebraska district court (*Zabel v. U.S.*, 82 AFTR2d 98-6334).

James D. Galloway created a trust naming his son, granddaughter and two charitable entities as equal beneficiaries. The trust directed that residual distributions would be paid in an installment of half of each beneficiary's share in 2006 and the remainder in 2016. After Galloway's death in 1998, the estate tax return included a nearly $400,000 deduction for the anticipated charitable distributions. The IRS disallowed the deduction, citing section 2055(e). The estate, with the son as trustee, paid the nearly $160,400 additional assessment, for which it filed a refund claim, complaint and, ultimately, appeal.

The government pointed to the statute's plain language that allows no deduction for a transfer to a charitable beneficiary where an interest in the same property also passes to a noncharitable beneficiary, except in the case of a charitable remainder annuity trust, charitable remainder unitrust or a pooled income fund. The estate argued that the statute's phrase "in the same property" was sufficiently vague to seek its meaning in the provision's legislative history, which indicated it was meant to apply only to charitable remainder trusts. By contrast, the estate said, because the Galloway trust designated equal shares, its terms effectively amounted to separate trusts for the charitable and noncharitable beneficiaries. Otherwise, to allow the government to elevate form so far above substance would ignore and harm the trust's charitable intent and effect, it said.

The court acknowledged that the kind of split-interest trust that appeared to have been uppermost in the congressional mind was one in which a noncharitable beneficiary held a life interest and the charitable beneficiary a remainder inter-

est. The life interest could be exploited to the hazard of the charitable remainder by high-return, high-risk investments. Thus, Congress allowed such splits only for annual distributions of fixed sums (charitable remainder annuity trust) or percentages of trust assets (unitrust), or for an irrevocable interest to the charity with a life interest retained by the donor (pooled income fund). But it was plain, if regrettable, that the statute itself left no choice: "We recognize the unfortunate result in this case," since "the abuses Congress sought to protect against are not present here," the court said. Also, the court found no evidence the estate even attempted to divide the trust property.

Financial advisers are thus put on notice that failure to separate charitable and noncharitable trust interests or distribute trust proceeds in the manner allowed by the statute will most likely result in disallowance of any claimed deductions for charitable transfers.

■ *Edmond C. Galloway v. U.S.*, 99 AFTR2d 2007-3412

Prepared by JofA staff member ***Paul Bonner***.

CHARITABLE DEDUCTIONS

CHARITY BEGINS WITH OWNERSHIP

The Tax Court ruled that a criminal defense attorney who donated case materials in a prominent case to the University of Texas did not have sufficient ownership rights to the materials to claim a charitable deduction under IRC § 170. Even if the taxpayer did exhibit proper ownership, section 170(e)(1)(A) would limit his deduction to zero—his cost basis in the materials. Based on the disallowed deductions, the taxpayer was found liable for deficiencies in 2000 and 2001.

Leslie Stephen Jones represented accused Oklahoma City bomber Timothy McVeigh from May 1995 until Jones withdrew from the case in August 1997. McVeigh was convicted in June 1997 and subsequently executed for the bombing of the Alfred P. Murrah Federal Building, which killed 168 people. Jones donated to the university materials in his possession, which included FBI case notes, witness interviews, medical examiner reports, photographs and computer disks, among many other materials tied to the case.

Based upon an appraiser's valuation, Jones and his wife claimed a charitable deduction of $294,877 in 1997, which was carried over from their 1997, 1998 and 1999 joint federal income tax returns. The IRS denied the deduction and assessed deficiencies of $3,675 for 2000 and $11,110 for 2001.

Since state law controls the nature of a taxpayer's legal interest in property, the court first examined whether Jones had a property interest in the donated materials under Oklahoma state law. In denying

Jones' assertion that he owned the materials, the court noted the unique fiduciary relationship between an attorney and a client. The rules of ethics charge an attorney in that role with the safekeeping of a client's property.

The court said the attorney-client relationship is fundamentally one of agency, and the delivery of materials to Jones by various investigating government agencies occurred within the scope of that agency relationship. Though Oklahoma courts have not ruled on this specific fact pattern, the court cited cases showing the weight of authority supports the notion that clients are the legal owners of their case files, including the attorney's work product. Furthermore, the rules of ethics would prevent Jones from disclosing or capitalizing on any information related to his representation of McVeigh absent an explicit waiver of the attorney-client privilege. No proof of waiver was presented.

The court further noted that even if Jones could prove ownership, section 170(e)(1)(A) requires the deduction be reduced by the amount of gain that would not have been long-term gain if the property contributed had been sold at its fair market value. Since the property would be work product that fell under the letter, memorandum or similar property exclusion from long-term gain treatment under section 1221(a)(3), Jones would have been left to deduct only his basis in the property, which was zero.

This case should highlight for tax practitioners the close intersection of state law and federal tax law when property rights are at issue. It should also give attorneys pause to consider the ethical implications of divulging to third parties any information obtained in the course of the attorney-client relationship—for tax benefit or otherwise.

■ *Sherrel and Leslie Stephen Jones v. Commissioner*, 129 TC no. 16

Prepared by JofA *staff member* ***Jeffrey Gilman****, Esq.* ❖

Line Items

TAXPAYER ADVOCATE PRESENTS ANNUAL WISH LIST

National Taxpayer Advocate Nina Olson presented her annual report to Congress in January recommending dozens of issues for the IRS and Congress to resolve this year. The report analyzes issues in 26 categories, including collection and tax services, privacy protection and tax preparer standards.

Late tax-law changes. Olson said paper and electronic filers may not be claiming deductions because Form 1040 and its instructions are often finalized after tax preparation software packages have been completed. She recommended the IRS create a formal process to update Congress' taxwriting committees, starting June 30, about how tax filing might be slowed by late changes to the Tax Code.

Tax gap. The report recommended the IRS establish a "cash economy program office" to improve compliance in the cash economy. The IRS has already rejected this suggestion. The report said the cash economy accounts for about $100 billion of the estimated annual tax gap of between $290 billion and $345 billion, as determined by a 2001 IRS analysis.

Private debt collection. Olson called for repeal of the use of private debt collection agencies to collect back taxes. She estimated the $7.35 million appropriated to this program in fiscal 2008 would result in $30 million in collections, compared with $146 million that could be collected through the IRS's Automated Collection System.

Apology payments. Taxpayers should be given nontaxable "apology payments" of between $100 and $1,000 if they suffer undue burdens or excessive expenses caused by IRS mistakes or inaction.

Circular 230. The report called on the IRS Office of Professional Responsibility to clarify some aspects of Circular 230, particularly whether tax advice is a "covered opinion," what constitutes "willful" conduct, and whether a statute of limitations applies to violations.

Tax preparer standards. The report highlighted the risk created by heightened preparer standards of "more likely than not" under IRC § 6694. This change gives a preparer the incentive to choose a course that protects the preparer's own interests rather than the taxpayer's.

Tax strategy patents. Olson also called on Congress to pass pending legislation banning tax strategy patents or barring their enforcement (see "On Equal Terms," page 68). If Congress does not outlaw such patents, it should require the U.S. Patent and Trademark Office to refer them to the IRS to review whether their strategies are abusive.

Most-litigated issues. Congress should expand the spousal protections of sections 66 and 6015. The proposed changes would allow defenses under those sections to be raised in a collections action in district court. Current law allows the defenses in district court only in a refund action. Joint and several liability under section 6015 was the ninth most-litigated issue in the past year.

The third most-litigated issue involved summons enforcement under sections 7602, 7604 and 7609. The report listed several cases to illustrate the Service's more aggressive stand in such matters, including the recent *Textron* case, in which a lower court granted work product protection to third-party workpapers (see "Tax Matters: Work Product Stands Up to IRS Summons," *JofA*, Nov. 07, page 80).

The report is available at **www.irs.gov/advocate/article/0,,id=177301,00.html.**

GAO: OFFSHORE REMITTANCES UNDERWITHHELD

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lars in U.S.-source income continue to flow overseas without proper tax withholding, the Government Accountability Office said. QIs are foreign financial institutions that contract with the IRS to provide withholding of U.S. tax and administer treaty provisions. However, they figure in a relatively small portion of U.S. money going offshore—only about 12.5% of the $293 billion that left the country in 2003, according to the most recent data available, the GAO said. Income flowing through U.S. financial institutions or other "withholding agents" may be more vulnerable to offshore tax evasion by U.S. taxpayers, since, unlike QIs, those institutions don't always require direct documentary verification of account owners' identities, the GAO said.

But despite their more stringent identification requirements and smaller volume, QIs handled more money with unknown tax jurisdictions ($11.3 billion) than did U.S. withholding agents ($7.8 billion). The average withholding rate by both conduits combined was 2.7%. IRS officials were unable to explain why that rate was so much lower than the statutory withholding rate, barring any exemption or treaty reduction, of 30%. They said the unknown jurisdictions for QI accounts could be a byproduct of a feature intended to make them more attractive—accounts may be pooled for reporting to the IRS rather than listed individually.

GEORGIA TAX COURT EYED

Practitioners hope to see a state tax court started in Georgia, one of 27 states lacking a dedicated tax court or administrative appeals forum fully independent of a state revenue agency. Besides removing proceedings from any appearance of bias, an independent tax tribunal offers several other advantages including a less crowded docket, greater tax expertise from the bench, more uniformity and published decisions, proponents say. The State Bar of Georgia's Taxation Law Section has drafted a proposed bill to establish the court, which would hear appeals from the state Department of Revenue. Filing a petition would stay an enforcement or collection action, eliminating the "pay to play" requirement currently in effect.

Under Georgia's present system, taxpayers not satisfied with a state revenue assessment may appeal to a state superior court or the Office of State Administrative Hearings, whose decisions are not binding on the Department of Revenue. The proposed legislation would grant the tax court and superior courts concurrent jurisdiction to hear appeals. The new court would also include a small-claims venue.

Proponents hope to introduce legislation in the state's 2009 legislative session. The court will require a pilot program, with approval by two-thirds of each legislative chamber required to become a permanent body, said Peter Stathopoulos, managing director of state and local taxes of Atlanta-based accounting firm Bennett Thrasher PC, and John Allan, tax partner at law firm Jones Day's Atlanta office. Allan chairs, and Stathopoulos is a member of, the State Bar of Georgia's task force that drafted the proposed legislation. Both are CPAs and attorneys.

In its 2007 publication of *The Best and Worst of State Tax Administration*, the Council on State Taxation listed 21 states as lacking an independent tax dispute forum and gave another six an intermediate ranking. The study can be read at **www.statetax.org/Content/ContentGroups/Home_Page_Content/COST_Studies,_Articles_and_Testimony/2007BestAndWorstScorecardAmended.pdf**.

PPA REGS DELAYED, GUIDANCE ISSUED

The IRS delayed implementation and provided transitional guidance for proposed regulations under new provisions of the Pension Protection Act of 2006 that relate to funding requirements and benefits of single-employer defined-benefit pension plans. Prop. Treas. Reg. §§ 1.430(f)-1 and 1.430(h)(3)-2, which address maintaining certain funding balances and use of substitute mortality tables, respectively, were originally proposed to apply to plan years beginning on or after Jan. 1, 2008.

In Notice 2008-21, the IRS announced a one-year delay in their effective date. For plan years beginning during 2008, taxpayers should note that they may use mortality tables that are substitutes for the standard tables of IRC § 430(h)(3)(A) only if those tables are approved pursuant to Revenue Procedure 2007-37. The guidance also covers other interim considerations including a transition rule for calculation of benefit limitations under IRC § 436.

AICPA ISSUES GUIDANCE FOR 2007 RETURNS ON TRUSTEE COSTS

The AICPA has produced guidance for members preparing 2007 fiduciary income tax returns, in keeping with the recent holding of the U.S. Supreme Court in *Knight v. Commissioner.* The case (101 AFTR2d 2008-380) affirmed that investment advisory fees of estates and nongrantor trusts generally are subject to the 2% of adjusted gross income floor as miscellaneous itemized deductions, except to the extent they are incremental to or different from what an ordinary individual would commonly incur (see "Tax Matters: Supreme Court Upholds Trust Expense Floor," *JofA*, March 08, page 73). The guidance, prepared by the Section 67(e) Task Force of the AICPA's Trust, Estate and Gift Tax Technical Resource Panel, addresses such questions as the ruling's application to investment advisory fees, trustee fees, tax return preparation fees and other costs, as well as substantiation requirements for treatment of items. The guidance may be downloaded at **http://tax.aicpa.org/Resources/Trust+Estate+and+Gift/Trusts/AICPA+Guide+on+Trust+Advisory+Fees+for+Form+1041.htm**. Other case materials and commentary are available at **http://tax.aicpa.org/Resources/Trust+Estate+and+Gift/Trusts**. ❖

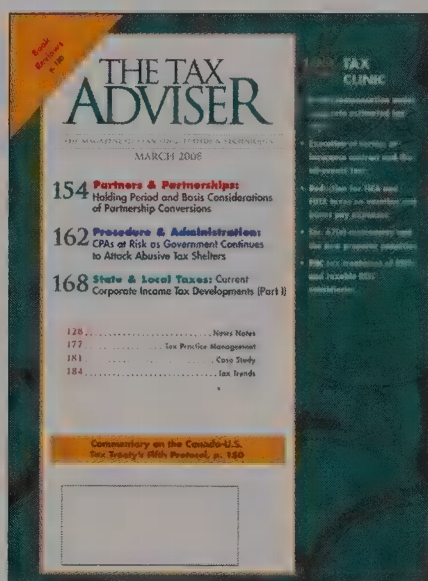
DISCLOSURE OF TAXPAYER INFORMATION

Return Preparers Subject to New Regulations

Section 7216 of the Internal Revenue Code imposes criminal penalties on tax return preparers who knowingly or recklessly make unauthorized disclosures or uses of information furnished to them in connection with the preparation of an income tax return. Newly finalized regulations should prompt all return preparers to evaluate their processes to ensure that they conform to the new requirements (TD 9375).

The final regulations are the first update to the rules governing preparer disclosure and privacy requirements since 1974. Return preparers will have until Jan. 1, 2009, to implement the new requirements.

The new rules affect only return preparers; they do not affect the strict rules governing how the IRS handles taxpayer information.



RETURN INFORMATION

The regulations provide a new definition of tax return information subject to the disclosure and use restrictions. This includes information that:

- The preparer derives or generates from tax return information in connection with preparation of a return;
- The preparer receives from the IRS in connection with processing returns; or
- Is a statistical compilation of tax return information, even in a form that cannot be associated with, or otherwise identify, a particular taxpayer.

Information furnished by the taxpayer for purposes of engaging a tax preparer to prepare a tax return is also considered return information and is therefore subject to the new rules. See Treas. Reg. § 301.7216-1(b)(3).

DISCLOSURE CONSENT

Under the new rules, preparers generally must obtain taxpayer consent, either by paper or electronically depending on how the return is being filed, before tax return information can be disclosed to any third party or used for any purpose other than filing the return. Such consent must identify the intended purpose of the disclosure, identify the recipients, and describe the particular authorized disclosure or use of the information.

The regulations include mandatory language that must be included in the consent informing individual taxpayers that (1) they are not required to sign the consent; (2) if they sign the consent, federal law may not protect their information from further disclosure; and (3) if they sign the consent, they can set the duration of that consent. If taxpayers fail to set a time period, the consent is valid for a maximum of one year.

To protect taxpayers from being pressured with repeated consent requests regarding the same issue, if a taxpayer declines to provide consent for an unrelated tax preparation disclosure or use request, the preparer cannot make a similar consent request.

Finally, preparers must obtain consent from taxpayers before sending tax information to another preparer outside the United States. This is to ensure that taxpayers know when their returns are being sent offshore for preparation. In such cases, the regulations require that the taxpayer's Social Security number be redacted.

For a detailed discussion of the issues in this area, see "New Rules for Disclosure and Use of Tax Return Information by Tax Return Preparers," by Michael P. Dolan, Esq., CPA, in the April 2008 issue of *The Tax Adviser*.

—Alistair M. Nevius, editor-in-chief
The Tax Adviser

Also look for articles on the following subjects in the April 2008 issue of *The Tax Adviser*:

- A report on tax accounting and the federal criminal code.
- An update on state corporate income tax developments.
- A discussion of the withholding rules for U.S. source income of foreign persons.

Notice to Readers:

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Technology Q&A

by Stanley Zarowin

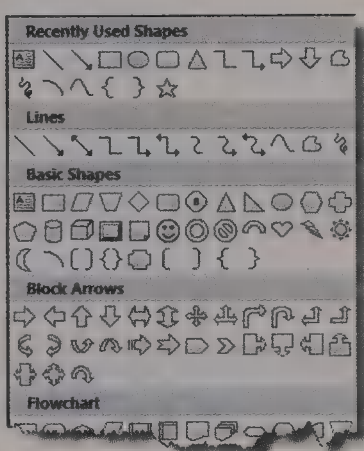
Add pizazz to arrows and pointers in Excel spreadsheets…Customize Excel's cursor direction after entering data…Update on erasing the shortcut icon arrows…A better way…Shortcuts

ADD PIZAZZ TO ARROWS AND POINTERS IN EXCEL SPREADSHEETS

Q When I do a presentation that includes spreadsheets, I usually use arrows to illustrate the relationship between numbers, and while it works OK, it lacks pizazz. Is there some way I can add more impact to my spreadsheets?

A There are lots of things you can do—such as adding color, size and shape. Let's look at the options.

If you're using Excel 2007, click on **Insert** and then on **Shapes**, which produces this menu:



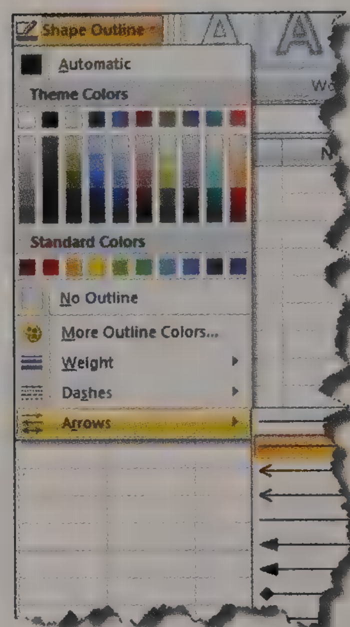
Once you click on a shape, the **Home Ribbon** switches to **Format** and, depending on which shape you select, that menu automatically adjusts to the special options for your selection (see screenshot atop next column).

» Key to Instructions

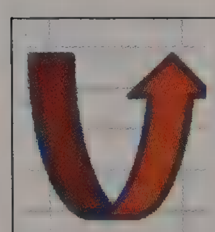
To help readers follow the instructions in this article, we use two typefaces:

Boldface *type is used to identify the names of functions, menu items, icons, agendas and URLs.*

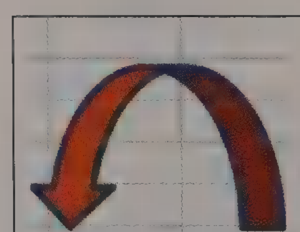
Sans serif *type shows the names of files and the names of commands and instructions that users should type into the computer.*



Not only do you have many choices, but each shape is easily adjustable, for example, by grabbing its edge with your cursor and reshaping it, say, from…

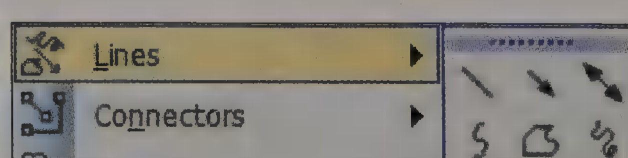


this…

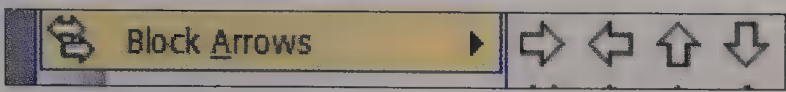


…to this.

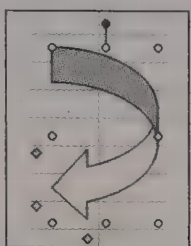
In Excel 2003, however, you have fewer options and the customization steps are not as convenient. Begin by clicking on **View**, **Toolbars**, **Drawing** and then go to the bottom of the screen and either click on the simple arrow in the toolbar or click on **AutoShapes**, and then **Lines** if you want still more choices…



…or **Block Arrows** if you want an arrow that you can make a bit fancier…



…and click on your selection. Now move your cursor to where you want it to appear in the worksheet and click. If you choose **Block Arrows**, you can customize some of the choices by clicking and dragging, for example:



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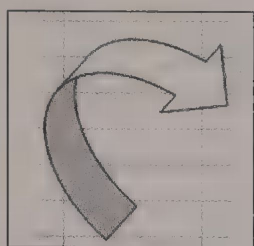
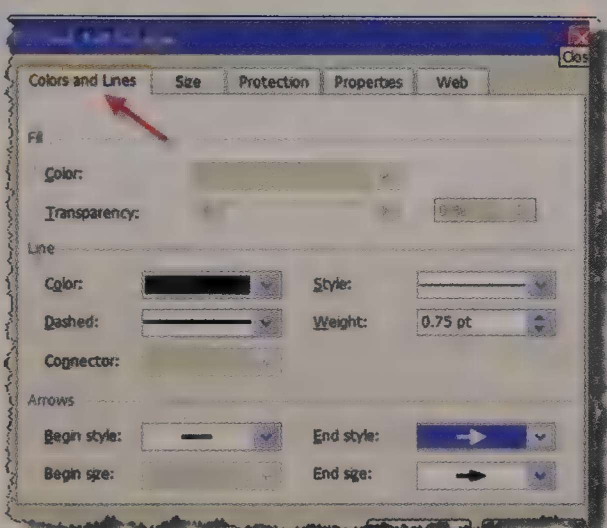


…to this.

Now, to gussy it up further, go to the toolbar on the top of the screen and click on **Format**, **AutoShape** and this screen will appear:

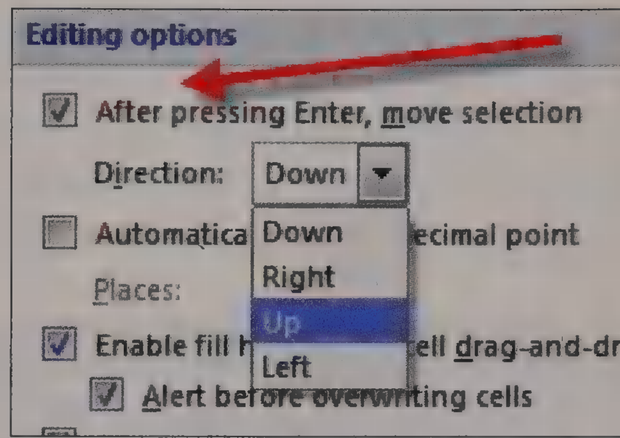


Make sure the **Colors and Lines** tab is selected, and now you can customize both the arrow line and arrowhead. You also can choose whether and how much you want the arrow image to be transparent so the data below can show through.

CUSTOMIZE EXCEL'S CURSOR DIRECTION AFTER ENTERING DATA

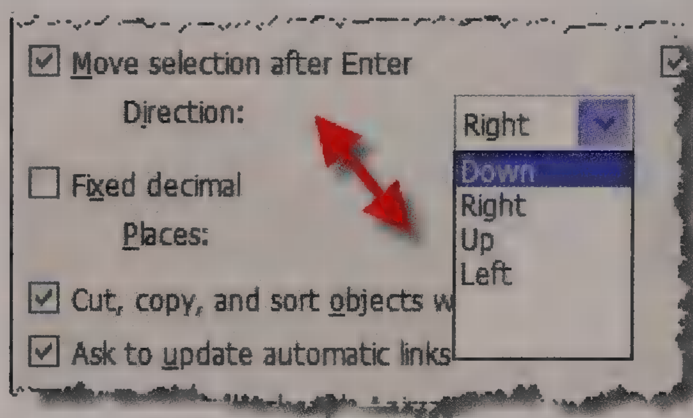
Q When I was using Excel 2003, I could easily adjust which direction the cursor would move—either to the right or down—after I entered data in a cell. But Office 2007 doesn't seem to give me a choice. Is there a way to adjust that default?

A There is, and it's tucked under the **Ribbon**. And I don't know whether you realize it, but as you'll shortly see, you have more choices than moving it to the right or down. To access the default adjustment, click on the **Microsoft Office Button** and then on **Excel Options** at the bottom of the screen and on **Advanced**, which produces this screen:



Notice you have the option of moving it down, up, right and left.

In Office 2003, access the adjustment by clicking on **Tools**, **Options**, **Edit**, generating this screen:



One more option: For some reason Microsoft doesn't tell you that, in both Office 2003 and 2007, a click on Tab will move the cursor to the right no matter how you set the default.

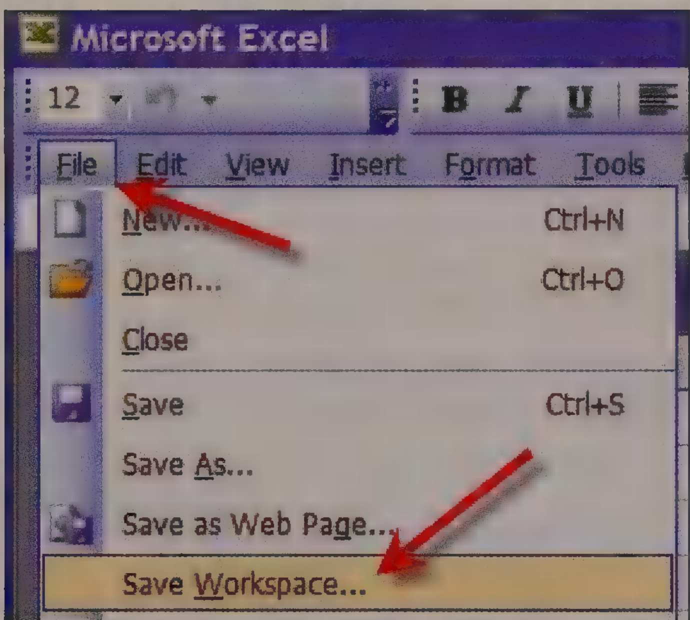
UPDATE ON ERASING THE SHORTCUT ICON ARROWS

In the January 2008 issue (page 80), I told how to eliminate those annoying little arrows in Windows XP's shortcut icons by running Microsoft's free Tweak UI tool. At that time there were no *free* tools to do the job for Vista. Well, there is now—FxVisor (also called Vista Shortcut Manager) from Frameworkx. Go to **www.frameworkx.com** and click on "downloads." In addition to just removing the arrow, FxVisor gives you these options: big arrow, small arrow, magnifying glass or nothing.

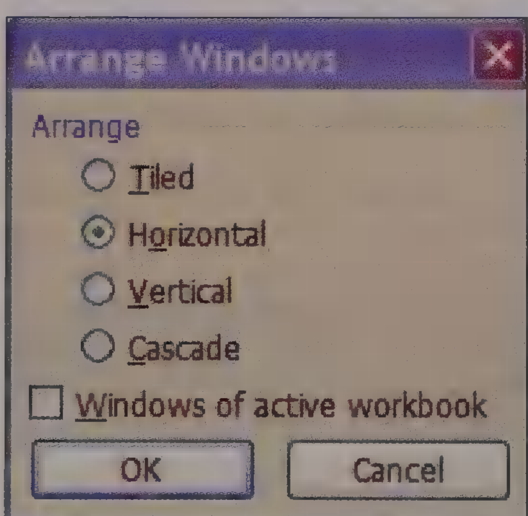
A BETTER WAY

In the January issue (page 82), I suggested an automatic way to open a group of Excel worksheets in just a few steps—a technique that is especially handy when you need to regularly reopen that group in the future. Several readers suggested a much better way to perform that task, applying Excel's **Save Workspace** function.

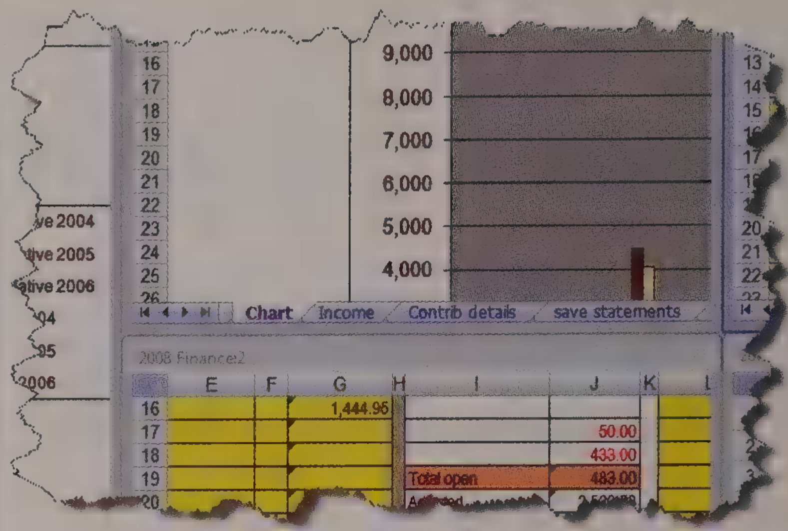
To use **Save Workspace** in Excel 2003, first open the files you want in the group and then click on **File**, **Save Workspace** (see screenshot below) and give it a name (it will automatically be given a .xlw extension).



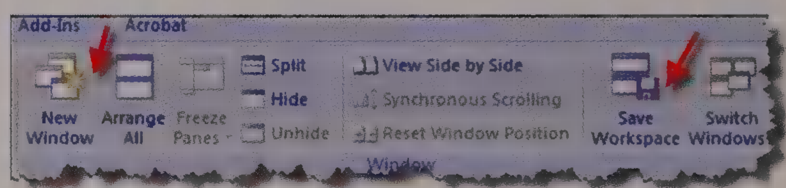
If you wish, you can customize the setup before you save the file so that selected worksheets within each file will open, or you can even customize it further by having several sections of worksheets all open and arranged on one screen. To do that, click on **Window**, **New Window** and **Arrange**, which brings up this screen:



You can arrange the worksheet layout in a way that lets you easily access just the data you need, as illustrated in the following screenshot:



Excel 2007 also has the **Save Workspace** function and, as expected, it's accessed differently. Open the target files and then go to the **Ribbon** and click on **View** to access both **New Windows** (so you can display more than one worksheet) and **Arrange All** (to customize the display). The **Save Workspace** icon is farther to the right.



Since there is no limit to the number of **Save Workspace** files you can store, you may want to establish one for each client or business category.

SHORTCUTS

- **Enlarge screen view:** Hold down Ctrl key and turn wheel on mouse—away from you to enlarge the screen view and toward you to shrink it.
- **Word:** To toggle from variations of letter capitalization to lowercase, highlight the target words and press Shift+F3. The words will toggle between all lowercase, all uppercase or just the first letter of each word uppercase. ❖

Stanley Zarowin *is a contributing editor to the* JofA. *His e-mail address is stanley.joatech@gmail.com.*

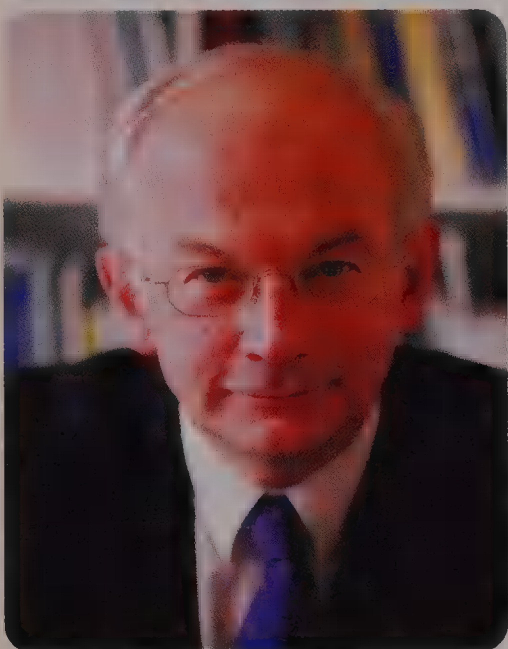
Do you have technology questions for this column? Or, after reading an answer, do you have a better solution? Send them to me via e-mail at stanley.joatech@gmail.com or via regular mail at the *Journal of Accountancy*, 220 Leigh Farm Road, Durham, NC 27707-8110.

Because of the volume of mail, I regret I cannot individually answer submitted questions. However, if a reader's question has broad interest, I will answer it in a forthcoming Technology Q&A column.

www.aicpa.org

Inside AICPA

Hopwood earns Lifetime Contribution Award...Communications awards recognize financial literacy campaigns...AICPA co-sponsors awards for research...Institute co-sponsors course for small businesses...Eisenberg receives PFP award...Where to Turn



Anthony Hopwood

PROFESSOR HONORED FOR WORK IN MANAGEMENT ACCOUNTING

Anthony Hopwood received the 2008 Lifetime Contribution Award from the Management Accounting Section of the American Accounting Association.

The award, sponsored by the AICPA, recognizes those who have made an important mark on management accounting, education and practice.

Hopwood, American Standard Companies Professor of Operations Management at Saïd Business School in Oxford, England, was honored for his research and teachings on organizational control and management perspectives.

He is also the editor-in-chief of *Accounting, Organizations and Society* and a former president of the European Institute for Advanced Studies in Brussels, Belgium. In 1998, he was voted the Distinguished Accounting Academic of the year by the British Accounting Association. He is also a former dean of the Saïd Business School.

INSTITUTE'S FINANCIAL LITERACY CAMPAIGNS WIN COMMUNICATIONS AWARDS

The Institute received 15 MarCom Awards and nine Hermes Creative Awards from the Association of Marketing and Communication Professionals.

More than half the awards were for the Feed the Pig campaign, a national public-service program, created in partnership with the Ad Council, to help Americans ages 25 to 34 prepare for long-term financial security.

The AICPA's 360 Degrees of Financial Literacy program, which educates Americans on important financial topics and issues affecting them at different stages of life, received a gold award for its Web site **www.360financialliteracy.org**.

Other awards went to two annual reports, three membership marketing brochures and staff orientation and retention videos.

AICPA TEAMS UP WITH AAA FOR TWO AWARDS

The AICPA, the Chartered Institute of Management Accountants in the United Kingdom and the Society of Management Accountants (CMA Canada) are co-sponsoring two new awards for research in management accounting for the American Accounting Association's Management Accounting Section.

The first award of $2,000 honors an early-career researcher with the best overall body of research in management accounting. The submission deadline is March 31.

The second award, also $2,000, recognizes the author of a single article with the greatest potential impact on practice. The submission deadline is Aug. 31.

For more information on these awards, visit the AAA Web site at **http://aaahq.org/mas**.

AICPA CO-SPONSORS FINANCIAL MANAGEMENT COURSE

The Institute, Dell Inc. and *PC Magazine* recently joined forces to help small businesses with financial management.

The free online course, "Financial Management Made Easy–Solutions for Small Businesses," is offered through *PC Magazine*'s Learning Center series for businesses employing up to 25 people. The program consists of three lessons:

- Technology Tools for Easy Financial Management
- Complete Solutions for Standardized Financial Reporting
- Financial and Accounting Compliance and Outsourced Resources

Ilene Eisen, CPA, CITP, a principal with California-based firm ie Solutions, is a guest instructor for the third lesson of the

course, which is available for download at **www.dell.com/financial_training**.

AWARD RECOGNIZES PERSONAL FINANCIAL PLANNING VOLUNTEER

Michael Eisenberg received the 2007 Personal Financial Planning Distinguished Service Award, which recognizes an AICPA volunteer who significantly contributes to the advancement of personal financial planning as a practice discipline and exemplifies the CPA as financial planner.

Eisenberg is a member of the National CPA Financial Literacy Commission, which directs the Institute's 360 Degrees of Financial Literacy and Feed the Pig campaigns.

"Michael is the embodiment of what it means to be a CPA financial planner," Jim Metzler, AICPA vice president–Small Firm Interests, said in a news release. "Through his many years as a volunteer on our financial planning committees and those of his home state of California, Michael has worked tirelessly and enthusiastically to advance the CPA's profile in the financial planning arena."

Eisenberg is principal of Eisenberg Financial Advisors, based in Los Angeles, and is a frequent commentator on financial planning topics in national and local media. He also contributed to the book *Tips from the Top: Targeted Advice from America's Top Money Minds.*

Eisenberg also is past chairman of the AICPA Personal Financial Specialist Credential Committee and past member of the AICPA PFP Editorial Board.

Dick Fohn, chairman of the Personal Financial Planning Executive Committee, and Bob Jazwinski, chairman of the Personal Financial Specialist Credential Committee, presented the award at the 2008 Advanced Personal Financial Planning Conference in Las Vegas.

Michael Eisenberg

PHOTO BY RICHARD FAVERTY

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  (financialliteracy@aicpa.org)
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  (Lenovo) . . . 800/426–7235, ext. 3373
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Exposure Drafts Outstanding

(This list was compiled as of Feb. 14, 2008. More current information may be available in *The CPA Letter* or at **www.aicpa.org**. *Note:* The policy for updating the list of exposure drafts is that a document should remain on the list until a final document has been issued or the project has been dropped. However, no comments will be received after the comments deadline has expired. The list is not all-inclusive but is intended to present the exposure drafts of particular interest to professional accountants.)

Issue Date	Title or Description	Comment Deadline
FASB		
4/18/07	Accounting for Financial Guarantee Insurance Contracts—an interpretation of FASB Statement No. 60	6/18/07
12/8/06	Disclosures About Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133	3/2/07
10/9/06	Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition (an amendment of FASB Statement No. 142)	1/29/07
10/9/06	Not-for-Profit Organizations: Mergers and Acquisitions	1/29/07
9/30/05	Earnings per Share—an amendment of FASB Statement No. 128 (revision of Exposure Draft issued 12/15/03)	11/30/05
8/11/05	Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140	10/10/05
4/28/05	The Hierarchy of Generally Accepted Accounting Principles	6/27/05
AcSEC (AICPA)		
9/12/07	Proposed Audit and Accounting Guide, Airlines	12/15/07
ASB (AICPA)		
5/9/05	Proposed Statement on Auditing Standards: Amendment to Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity with Generally Accepted Accounting Principles, for Nongovernmental Entities	6/27/05
OTHER (AICPA)		
12/3/07	Proposal of Professional Ethics Division, Interpretation on Failure to Follow Requirements of Governmental Bodies, Commissions, or Other Regulatory Agencies on Indemnification and Limitation of Liability Agreements With a Client	2/3/08
8/13/07	Proposal of Professional Ethics Division, Interpretation on Networks and Network Firms and Proposed Related Definitions	11/13/07
5/15/07	Proposed Interpretation 102-7, Other Considerations: Meeting the Objectives of the Fundamental Principles, and Proposed Framework for Meeting the Objectives of the Fundamental Pinciples	8/15/07
4/16/07	Proposed Revisions to the AICPA Standards for Performing and Reporting on Peer Reviews	6/30/07
12/13/06	Proposed Revisions to AICPA/NASBA Uniform Accountancy Act Section 23	5/15/07
3/7/01	Statement on Standards for Continuing Professional Education Programs	8/1/01
SEC		
6/26/02	Framework for Enhancing the Quality of Financial Information Through Improvement of Oversight of the Auditing Process; Release Nos. 33-8109; 34-46120; 35-27543; IA-2039; IC-25624	9/3/02
5/10/02	Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies (Release Nos. 33-8098; 34-45907)	7/19/02
4/12/02	Form 8-K Disclosure of Certain Management Transactions; Release No. 33-8090	6/24/02
4/12/02	Form 8-K Disclosure of Certain Management Transactions; Release No. 34-45742	6/24/02
2/18/00	SEC Concept Release: International Accounting Standards	5/23/00
1/21/00	Supplementary Financial Information	4/17/00
GASB		
6/29/07	Accounting and Financial Reporting for Derivative Instruments	10/26/07
10/20/06	Fund Balance Reporting and Governmental Fund Type Definitions (Invitation to comment)	1/31/07
IFAC		
1/15/08	Proposed Redrafted International Standard on Auditing ISA 210 (Redrafted), Agreeing the Terms of Audit Engagements	4/15/08
1/15/08	Proposed Redrafted International Standard on Auditing ISA 710 (Redrafted), Comparative Information-Corresponding Figures and Comparative Financial Statements	4/15/08
12/21/07	Proposed New International Standard on Assurance Engagements ISAE 3402, Assurance Reports on Controls at a Third Party Service Organization	5/31/08
12/21/07	Proposed New International Standard on Auditing ISA 265, Communicating Deficiencies in Internal Control	4/30/08
12/21/07	Proposed Revised and Redrafted International Standard on Auditing ISA 402 (Revised and Redrafted), Audit Considerations Relating to an Entity Using a Third Party Service Organization	4/30/08
12/21/07	Proposed Redrafted International Standard on Auditing ISA 501 (Redrafted), Audit Evidence Regarding Specific Financial Statement Account Balances and Disclosures	3/31/08
12/21/07	Proposed Redrafted International Standards on Auditing ISA 520 (Redrafted), Analytical Procedures	3/31/08
10/15/07	Proposed Revised and Redrafted International Standard on Auditing ISA 505 (Revised and Redrafted), External Confirmations	2/15/08
10/15/07	Proposed Revised and Redrafted International Standard on Auditing ISA 620 (Revised and Redrafted), Using the Work of an Auditor's Expert	2/15/08
10/1/07	Consultation Paper—Proposed Strategy for 2009–2011	11/30/07
9/5/07	Amendments to IPSAS 4, The Effects of Changes in Foreign Exchange Rates	12/31/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 700 (Redrafted), The Independent Auditor's Report on General Purpose Financial Statements	11/30/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 705 (Revised and Redrafted), Modifications to the Opinion in the Independent Auditor's Report	11/30/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 706 (Revised and Redrafted), Emphasis of Matter Paragraphs and Other Matter(s) Paragraphs in the Independent Auditor's Report	11/30/07

*New additions appear in **bold, blue** type.*

Issue Date	Title or Description	Comment Deadline
8/3/07	Proposed Redrafted International Standard on Auditing ISA 800 (Revised and Redrafted), Special Consideration—Audits of Special Purpose Financial Statements and Specific Elements, Accounts or Items of a Financial Statement	11/30/07
8/3/07	Proposed Redrafted International Standard on Auditing ISA 805 (Revised and Redrafted), Engagements to Report on Summary Financial Statements	11/30/07
7/31/07	Proposed Redrafted International Standard on Auditing ISA 510 (Redrafted), Initial Audit Engagements—Opening Balances	10/31/07
7/31/07	Proposed Redrafted International Standard on Auditing ISA 530 (Redrafted), Audit Sampling	10/31/07
5/1/07	ISA 250 (Redrafted), The Auditor's Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements	7/31/07
5/1/07	ISA 200 (Revised and Redrafted), Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance With International Standards on Auditing	9/15/07
5/1/07	ISA 500 (Redrafted), Considering the Relevance and Reliability of Audit Evidence	9/15/07
3/1/07	Proposed Redrafted International Standard on Auditing, ISA 570 (Redrafted), Going Concern	5/31/07
3/1/07	Proposed Revised and Redrafted International Standard on Auditing, ISA 550 (Revised and Redrafted), Related Parties	6/30/07
12/29/06	Proposed Revised Section 290 of the Code of Ethics for Professional Accountants, Independence—Audit and Review Engagements, and Proposed Section 291, Independence—Other Assurance Engagements	4/30/07
12/22/06	Proposed Revised and Redrafted International Standard on Auditing ISA 580 (Revised and Redrafted), Written Representations	4/30/07
12/22/06	Proposed Redrafted International Standard on Auditing ISA 560 (Redrafted), Subsequent Events	3/31/07
12/22/06	Proposed Redrafted International Standard on Auditing ISA 610 (Redrafted), The Auditor's Consideration of the Internal Audit Function	3/31/07
12/1/06	Strategic and Operational Plan, 2007–2009	2/28/07

Issue Date	Title or Description	Comment Deadline
11/22/06	Proposed Amendment to International Public Sector Accounting Standard, "Financial Reporting Under the Cash Basis of Accounting," "Financial Reporting Under the Cash Basis of Accounting—Disclosure Requirements for Recipients of External Assistance"	3/31/07
11/15/06	Proposed Drafted International Standards on Auditing ISA 320 (Revised and Redrafted), Materiality in Planning and Performing an Audit ISA 450 (Redrafted), Evaluation of Misstatements Identified During the Audit	2/15/07
10/26/06	Proposed International Public Sector Accounting Standard, Employee Benefits	2/28/07
10/18/06	Proposed International Public Sector Accounting Standard, Impairment of Cash-Generating Assets	2/28/07
FASAB		
8/3/07	Reporting Gains and Losses From Changes in Assumptions and Selecting Discount Rates and Valuation Dates	1/15/08
6/11/07	Implementation Guide for SFFAS 29: Heritage Assets and Stewardship Land	8/13/07
6/4/07	Clarification of Standards Related to Inter-Entity Cost	8/6/07
5/21/07	Accounting for Federal Oil and Gas Resources	1/11/08
10/23/06	Accounting for Social Insurance, Revised (Preliminary Views)	4/16/07
PCAOB		
10/17/07	An Audit of Internal Control That Is Integrated With an Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies	12/17/07
4/3/07	Proposed Auditing Standard—Evaluating Consistency of Financial Statements and Proposed Amendments to Interim Auditing Standards	5/18/07
5/23/06	Proposed Rules on Succeeding to the Registration Status of a Predecessor Firm	7/24/06
5/23/06	Proposed Rules on Periodic Reporting by Registered Public Accounting Firms	7/24/06
10/26/04	Proposed Rule on Procedures Relating to Subpoena Requests in Disciplinary Proceedings	11/29/04
XBRL		
12/5/07	US GAAP Taxonomies and related documentation public review	4/4/08

INFORMATION

The initials stand for the following organizations. Exposure drafts are available online at the Web addresses below or copies may be obtained at the address in parentheses (unless otherwise indicated).

FASB– Financial Accounting Standards Board (Order Department, Financial Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116); also available online at **www.fasb.org**

GASB– Governmental Accounting Standards Board (Order Department, Governmental Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116); also available online at **www.gasb.org**

AICPA– American Institute of CPAs (American Institute of Certified Public Accountants, 220 Leigh Farm Road, Durham, NC 27707-8110). AICPA publishes exposure drafts exclusively on the Web at **www.aicpa.org**. Print copies are not available.

IASB– International Accounting Standards Board (International Accounting Standards Board, 30 Cannon Street, London EC4M 6XH, United Kingdom), also available online at **www.iasb.org**

IFAC– International Federation of Accountants (International Federation of Accountants, 545 Fifth Avenue, 14th Floor, New York, NY 10017); also available online at **www.ifac.org**

SEC– Securities and Exchange Commission (Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549); also available online at **www.sec.gov**

FASAB– Federal Accounting Standards Advisory Board (Federal Accounting Standards Advisory Board, 441 G Street, N.W., Suite 6814, Washington, DC 20548); also available online at **www.fasab.gov**

PCAOB– Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, DC 20006-2803; **www.pcaobus.org**

XBRL– eXtensible Business Reporting Language US Jurisdiction. XBRL US GAAP Taxonomies available exclusively at **www.xbrl.us**

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New & Noteworthy

9 Questions to Test Your Firm's Tech IQ

Up-to-date IT systems become a competitive necessity

By William C. Fleenor and Randolph P. Johnston

Adapted from *eMAP: Management of an Accounting Practice Handbook*

Technology represents a tremendous opportunity for firms to reduce costs, improve quality of services to clients, and grow their practices. No CPA who has prepared a tax return in years gone by can doubt the tremendous benefits technology has provided. Without question, technology has significantly improved productivity in public accounting over the last 30 years.

Despite the improvements we have already realized, many CPA firms still are not even close to taking full advantage of benefits currently available from well-established technology solutions.

This is both good and bad news. The bad news is that we are still wasting lots of time and are not nearly as productive and effective as we could be. The good news is that we have come far, and there are still many great opportunities to make additional large gains.

See How Your Firm Stacks Up

How many of the following questions can you answer "yes" for your firm?

1. Do partners and managers have immediate and always up-to-date access to what your people are doing and how productive they are?
2. Do you know the current status of all jobs under way in your firm?
3. Can you handle simple requests from clients instantly and immediately without disrupting your current work? For example, a client calls and requests a copy of a prior year's return and financial statements.
4. Is technology being used consistently and to an equal extent by all the members of your firm from staff accountants up to and including partners?
5. Can you find any document you want at any time in a matter of seconds?
6. Do you have software and systems to continuously monitor workflow processes?
7. Are your control procedures for monitoring due dates, job progress, and other mission critical processes set up so that partners are automatically notified (without human intervention) any time any serious problem exists?
8. Have you assessed all the risks associated with technology failures and designed procedures to effectively manage these risks? For example, what will you do if your servers crash on April 11th and you cannot get them back up?
9. Are you continuing, year after year, to experience measurable increases in productivity from your staff directly as a result of taking better advantage of technology?

Equipping staff with high-quality desktops, laptops, and handhelds not only improves productivity far beyond the cost, it also has other tangible benefits. Well-equipped staffers are more likely to be satisfied with their job, and employee retention is improved. In providing continuing professional education seminars for state CPA societies, we have had numerous participants tell us they are planning to change firms because their current firm is behind in the area of technology implementation.

William C. Fleenor, CPA/CITP, Ph.D., is Partner and Randolph P. Johnston is Executive Vice President at K2 Enterprises. This is adapted from *e-MAP: Management of an Accounting Practice Handbook,* Product No. MAP-XX. Available at *www.CPA2Biz.com* or 1-888-777-7077.

New Resources

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Official Releases

SSARS NO. 17

SSARS NO. 17

Statement on Standards for Accounting and Review Services–Omnibus Statement on Standards for Accounting and Review Services–2008

(Amendment to Statement on Standards for Accounting and Review Services [SSARS] No. 1, Compilation and Review of Financial Statements *[AICPA,* Professional Standards, *vol. 2, AR sec. 100.01, 100.03–100.04, 100.06, 100.26–.27, 100.31, 100.36, 100.70, 100.72–.73, 100.86–.89]; amendment to SSARS No. 2,* Reporting on Comparative Financial Statements *[AICPA, Professional Standards, vol. 2, AR sec. 200.01, 200.29, 200.33]; amendment to SSARS No. 3,* Compilation Reports on Financial Statements Included in Certain Prescribed Forms *[AICPA,* Professional Standards, *vol. 2, AR sec. 300.01–300.03]; and amendment to SSARS No. 4,* Communications Between Predecessor and Successor Accountants *[AICPA,* Professional Standards, *vol. 2, AR section 400.01])*

Amendment to AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.01, 100.03–100.04, 100.72–100.73), AR Section 200, *Reporting on Comparative Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 200.01, 200.29, 200.33), AR Section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (AICPA, *Professional Standards*, vol. 2, AR sec. 300.01–300.03), and AR Section 400, *Communications Between Predecessor and Successor Accountants* (AICPA, *Professional Standards*, vol. 2, AR sec. 400.01)—Replacement of term *nonpublic entity* with *nonissuer*.

1. AR section 100, *Compilation and Review of Financial Statements*, sets forth the performance and communication requirements when an accountant submits unaudited financial statements of a nonpublic entity to his or her client or third parties. This amendment revises AR section 100 by replacing the term *nonpublic entity* with *nonissuer*. This revision conforms to the terminology utilized by other standard setters, including the Auditing Standards Board. New language is shown in boldface italics; deleted language is shown by strikethrough. Note that only those definitions in paragraph .04 of AR section 100 that are revised, deleted, or added as a result of this amendment are reflected below. All other definitions are unchanged.

.01 This section sets forth the performance and communication requirements when an accountant submits unaudited financial statements of a ~~nonpublic entity~~ ***nonissuer*** to his or her client or third parties. The accountant should not submit unaudited financial statements of a ~~nonpublic entity~~ ***nonissuer*** to his or her client or a third party unless, as a minimum, he or she complies with the provisions of this section applicable to a compilation engagement.

a. Compilation of financial statements.[1] If the accountant performs a compilation, a communication to management is required. The type of communication depends on the following.
    1. If the accountant is engaged to report on compiled financial statements or submits financial statements to a client that are or reasonably might be expected to be used by a third party, see paragraphs ~~.11–.21~~ ***.13–.23*** for reporting requirements.
    2. If the accountant submits financial statements to a client that are not reasonably expected to be used by a third party, see paragraphs ~~.22–.25~~ ***.24–.27*** for required communications to management.

    In deciding whether the financial statements are or reasonably might be expected to be used by a third party, the accountant may rely on management's representation without further inquiry, unless information comes to his or her attention that contradicts management's representation.

    In each of the above circumstances, the performance requirements in paragraphs .05 and ~~.07 through .10~~ ***.09–.12*** apply.
b. Review of financial statements.[2] If the accountant performs a review, see paragraphs .05 and ~~.26 through .48~~ ***.28–.53*** for performance and reporting requirements.

.03 An accountant should not consent to the use of his or her name in a document or written communication containing unaudited financial statements of a ~~nonpublic entity~~ ***nonissuer*** unless (*a*) the accountant has compiled or reviewed the financial statements in compliance with the provisions of this statement or (*b*) the financial statements are accompanied by an indication that the accountant has not compiled or reviewed the financial statements and that the accountant assumes no responsibility for them. For example, the indication may be worded as follows:

The accompanying balance sheet of X Company as of December 31, 20X1, the related statements of income, and cash flows for the year then ended were not audited, reviewed, or compiled by us and, accordingly, we do not express an opinion or any other form of assurance on them.

If an accountant becomes aware that his or her name has been used improperly in any client-prepared document containing unaudited financial statements, the accountant should advise the client that the use of his or her name is inappropriate and should consider what other actions might be appropriate, including consultation with his or her attorney. [As amended, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9.]

.04 Certain terms are defined for purposes of this section as follows.

~~Nonpublic entity. Any entity other than (a) one whose debt or equity securities trade in a public market either on a stock exchange (domestic or foreign) or in the over the counter market, including debt or equity securities quoted only locally or regionally; (b) one that makes a filing with a regulatory agency in preparation for the sale of any class of its debt or equity securities in a public market; or (c) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (a) or (b). (See AR section 200, Reporting on Comparative Financial Statements).~~

Financial statement. A presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with generally accepted accounting principles (GAAP)[5] or an OCBOA.[6]

1. See Appendix A [paragraph ~~.84~~***.97***], "Compilation of Financial Statements," for a flowchart ~~describing~~ ***regarding*** the requirements of Statements on Standards for Accounting and Review Services (SSARSs) for a compilation engagement.

2. [Footnote deleted by the issuance of Statement on Standards for Accounting and Review Services No. 15, July 2007]

5. [Footnote deleted by the issuance of Statement on Standards for Accounting and Review Services No. 15, July 2007]

~~6. Hereafter, reference to generally accepted accounting principles (GAAP) in this Section includes, where applicable, OCBOA.~~

Reference in the SSARSs to GAAP include, where applicable, an OCBOA. Financial forecasts, projections and similar presentations,[7] and financial presentations included in tax returns are not financial statements for purposes of this section. The following financial presentations are examples of financial statements and are not meant to be all-inclusive:[8]

Appropriate GAAP financial statement titles:

- Balance sheet
- Statement of income
- Statement of comprehensive income
- Statement of retained earnings
- Statement of cash flows
- Statement of changes in owners' equity
- Statement of assets and liabilities (with or without owners' equity accounts)
- Statement of operations
- Statement of revenue and expenses
- Statement of financial position (condition)
- Statement of activities
- Summary of operations
- Statement of operations by product lines

Appropriate OCBOA financial statezment titles:

- Balance sheet—cash basis
- Statement of assets and liabilities arising from cash transactions
- Statement of assets, liabilities, and stockholders' equity—income tax basis
- Statement of revenue collected and expenses paid
- Statement of revenue and expenses—income tax basis
- Statement of income—statutory basis
- Statement of operations—income tax basis

A financial statement may be, for example, that of a corporation, a consolidated group of corporations, a combined group of affiliated entities, a not-for-profit organization, a governmental entity, an estate or trust, a partnership, a proprietorship, a limited liability partnership (LLP), a limited liability company (LLC), a segment of any of these, or an individual. The method of preparation (for example, manual or computer preparation) is not relevant to the definition of a financial statement.

Issuer. ***An issuer is defined in section 3 of the Securities Exchange Act of 1934 [15 U.S.C. 78c], the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.***

Nonissuer. ***All entities except for those defined as issuers.***

7. Statement on Standards for Attestation Engagements No. 10, Chapter 3, *Financial Forecasts and Projections* [AT section 301], as well as the AICPA *Guide for Prospective Financial Information*, provide guidance on preparing and reporting on financial forecasts, projections, and similar presentations.

8. [Footnote deleted by the issuance of Statement on Standards for Accounting and Review Services No. 15, July 2007]

Communicating to Management and Others

~~.72~~*.85* The disclosure of any evidence or information that comes to the accountant's attention during the performance of compilation or review procedures that fraud or an illegal act may have occurred to parties other than the client's senior management (or the client's board of directors, if applicable) ordinarily is not part of the accountant's responsibility and ordinarily would be precluded by the accountant's ethical or legal obligations of confidentiality. The accountant should recognize, however, that in the following circumstances a duty to disclose to parties outside of the entity may exist:

a. To comply with certain legal and regulatory requirements

b. To a successor accountant when the successor decides to communicate with the predecessor accountant in accordance with ~~SSARS No. 4~~ ***AR section 400****, Communications Between Predecessor and Successor Accountants* ~~[section 400], as amended,~~ regarding acceptance of an engagement to compile or review the financial statements of a ~~nonpublic entity~~ ***nonissuer***

c. In response to a subpoena

Because potential conflicts between the accountant's ethical and legal obligations for confidentiality of client matters may be complex, the accountant may wish to consult with legal counsel before discussing matters covered by paragraph ~~.71~~*.84* with parties outside the client.

Change in Engagement From Audit to Review or Compilation (or From Review to Compilation)

~~.73~~*.86* An accountant who has been engaged to audit the financial statements of a ~~nonpublic entity~~ ***nonissuer*** in accordance with generally accepted auditing standards (or an accountant who has been engaged to review the financial statements of a ~~nonpublic entity~~ ***nonissuer*** in accordance with SSARSs) may, before the completion of the audit (review), be requested to change the engagement to a review or compilation (compilation) of financial statements. A request to change the engagement may result from a change in circumstances affecting the entity's requirement for an audit (review), a misunderstanding as to the nature of an audit, review, or compilation, or a restriction on the scope of the audit (review), whether imposed by the client or caused by circumstances.

2. AR section 200, *Reporting on Comparative Financial Statements*, establishes standards for reporting on comparative financial statements of a nonpublic entity when financial statements of one or more periods presented have been compiled and reported on or reviewed in accordance with AR section 100. This amendment revises AR section 200 by replacing the term *nonpublic entity* with *nonissuer*. This revision conforms to the terminology utilized by other standard setters, including the Auditing Standards Board. New language is shown in boldface italics; deleted language is shown by strikethrough.

.01 This statement establishes standards for reporting on comparative financial statements[1] of a ~~nonpublic entity~~ ***nonissuer*** when financial statements of one or more periods presented have been compiled and reported on or reviewed in accordance with ~~SSARS No. 1 [~~ ***AR*** section 100.~~]~~[2]

Reporting When One Period Is Audited

.29 When the current-period financial statements of a ~~nonpublic entity~~ ***nonissuer*** have been compiled or reviewed and those of the prior period have been audited, the accountant should issue an appropriate compilation or review report on the current-period financial statements and either (*a*) the report on the prior period should be reissued or (*b*) the report on the current period should include as a separate paragraph an appropriate description of the responsibility assumed for the financial statements of the prior period. In the latter case, the separate paragraph should indicate (*a*) that the financial statements of the prior period were audited previously, (*b*) the date of the previous report, (*c*) the type of opinion expressed previously, (*d*) if the opinion was other than unqualified, the substantive reasons therefor, and (*e*) that no auditing procedures were performed after the date of the previous report. An example of such a separate paragraph is the following:

The financial statements for the year ended December 31, 20X1, were audited by us (other accountants) and we (they) expressed an unqualified opinion on them in our (their) report dated March 1, 20X2, but we (they) have not performed any auditing procedures since that date.

Change of Status~~—Public/Nonpublic Entity~~
Issuer/Nonissuer

.33 For example, if the entity is ~~a public entity~~ ***an issuer*** in the current period and was a ~~nonpublic entity~~ ***nonissuer*** in the prior period, a compilation or review report previously issued on the financial statements of the prior period should not be reissued or referred to in the report on the financial statements of the current and one or more prior periods.[13] If an entity is a ~~nonpublic entity~~ ***nonissuer*** in the current period and was ~~a public entity~~ ***an issuer*** in the prior period, the annual financial statements of the prior period may have been audit-

1. This statement supersedes Statement on Standards for Accounting and Review Services No. 1, as amended, paragraph ~~79~~.92 [section 100[~~.79~~.92]]. [Footnote revised, May 2004, to reflect the conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 10.]

2. ~~For purposes of this Statement, a nonpublic entity is any entity other than (a) one whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over the counter market, including securities quoted only locally or regionally, (b) one that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market, or (c) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (a) or (b). This statement amends SSARS No. 1, paragraph 4 [section 100.04], by substituting the foregoing definition of a nonpublic entity.~~ The terms ***nonissuer,*** *financial statements*, *compilation*, and *review* are defined in paragraph 4 of SSARS No. 1 [section 100.04].

13. In these circumstances, the accountant should refer to ~~statements on~~ auditing standards ***promulgated by the Public Company Accounting Oversight Board*** for guidance on the appropriate method of reporting on the comparative financial statements. [Footnote renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005.]

(continued on page 98)

ed.[14] In these circumstances, the accountant should refer to paragraph .29 for guidance on the appropriate method of reporting on the comparative financial statements.

3. AR section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* establishes standards for reporting on comparative financial statements of a nonpublic entity when financial statements of one or more periods presented have been compiled and reported on or reviewed in accordance with AR section 100. This amendment revises AR section 300 by replacing the term *nonpublic entity* with *nonissuer*. This revision conforms to the terminology utilized by other standard setters, including the Auditing Standards Board. New language is shown in boldface italics; deleted language is shown by strikethrough.

.01 The requirements of AR section 100 and AR section 200 are applicable when the unaudited financial statements of a ~~nonpublic entity~~ ***nonissuer*** are included in a prescribed form. This statement amends AR section 100 and AR section 200 to provide for an alternative form of standard compilation report when the prescribed form or related instructions call for departure from generally accepted accounting principles by specifying a measurement principle not in conformity with generally accepted accounting principles or by failing to request the disclosures required by generally accepted accounting principles.[1] This ~~Statement~~ ***section*** also provides additional guidance applicable to reports on financial statements included in a prescribed form.[2]

.02 For purposes of this ~~statement~~ ***section***, a *prescribed form* is any standard preprinted form designed or adopted by the body to which it is to be submitted, for example, forms used by industry trade associations, credit agencies, banks, and governmental and regulatory bodies other than those concerned with the sale or trading of securities. A form designed or adopted by the entity whose financial statements are to be compiled is not considered to be a prescribed form. The terms *financial statement*, ***issuer***, and ~~nonpublic entity~~ ***nonissuer*** are defined in ~~paragraph 4 of SSARS No. 1 [section 100.04], as amended~~ paragraph ***.04*** of ***AR section 100***.

.03 There is a presumption that the information required by a prescribed form is sufficient to meet the needs of the body that designed or adopted the form and that there is no need for that body to be advised of departures from generally accepted accounting principles required by the prescribed form or related instructions. Therefore, in the absence of a requirement or a request for a review report on the financial statements included in a prescribed form, the following form of standard compilation report may be used when the unaudited financial statements of a ~~nonpublic entity~~ ***nonissuer*** are included in a prescribed form that calls for departure from generally accepted accounting principles:

> I (we) have compiled the (identification of financial statements, including period covered and name of entity) included in the accompanying prescribed form in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.
>
> My (our) compilation was limited to presenting in the form prescribed by (name of body) information that is the representation of management (owners). I (we) have not audited or reviewed the financial statements referred to above and, accordingly, do not express an opinion or any other form of assurance on them.
>
> These financial statements (including related disclosures) are presented in accordance with the requirements of (name of body), which differ from generally accepted accounting principles. Accordingly, these financial statements are not designed for those who are not informed about such differences.

4. AR section 400, *Communications Between Predecessor and Successor Accountants*, provides guidance on communications between a predecessor and successor accountant when the successor accountant decides to communicate with the predecessor accountant regarding acceptance of an engagement to compile or review the financial statements of a nonpublic entity. This amendment revises AR section 400 by replacing the term *nonpublic entity* with *nonissuer*. This revision conforms to the terminology utilized by other standard setters, including the Auditing Standards Board. New language is shown in boldface italics; deleted language is shown by strikethrough.

.01 This statement provides guidance on communications between a predecessor and successor accountant when the successor accountant decides to communicate with the predecessor accountant regarding acceptance of an engagement to compile or review the financial statements of a ~~nonpublic entity~~***nonissuer***.[1] This statement also provides guidance on inquiries a successor accountant may wish to make of a predecessor, and the predecessor's responses, to facilitate the conduct of the successor's compilation or review engagement. It also requires a successor accountant who becomes aware of information that leads him or her to believe the financial statements reported on by the predecessor accountant may require revision to request that the client communicate this information to the predecessor accountant.

Subsequent and intervening paragraphs and footnotes are renumbered.

5. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008. Early application is permitted.

Amendment to AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.04, 100.06, 100.26–.27, 100.31, and 100.86–.88)—Clarification of Objectives of Compilation Engagement and Review Engagement

6. Paragraph .04 of AR section 100 includes a definition of ***compilation of financial statements***. This amendment revises the definition of ***compilation of financial statements*** in paragraph .04 of AR section 100 and clarifies the objective of a compilation engagement as an engagement in which no assurance is provided and incorporating such objective in a new section entitled "Objective of a Compilation Engagement." In addition, the illustrative engagement letter for a compilation of financial statements and the illustrative engagement letter for a compilation of financial statements not intended for third party use are revised to incorporate the stated objective. This amendment also revises the definition of ***review of financial statements*** in paragraph .04 of AR section 100; revises and incorporates the objective of a review engagement in a new section entitled "Objective of a Review Engagement;" and revises paragraph .26 of AR section 100 to state that, in a review engagement, the accountant must (1) apply analytical procedures to the financial statements; (2) make inquires of management or other company personnel, or both; and (3) obtain representations from management for all financial statements and periods covered by the accountant's review report. Paragraph .31 of AR section 100 is also revised to properly state the above requirement with respect to analytical procedures. New language is shown in boldface italics; deleted language is shown by strikethrough. Note that only those definitions in paragraph .04 of AR section 100 that are revised as a result of this amendment are reflected below. The revisions made pursuant to paragraph 1 of this proposed Statement on Standards for Accounting and Review Services are not reflected below. All other definitions are unchanged.

DEFINITIONS

.04 Certain terms are defined for purposes of this section as follows.

Compilation of financial statements. ***A service, the objective of which is to present in the form of financial statements, information that is the representation of management (owners) without undertaking to express any assurance on the financial statements.*** ~~Presenting in the form of financial statements[9] information that is the representation of management (owners) without undertaking to express any assur-~~

14. If an unaudited disclaimer of opinion was previously issued on the financial statements of the prior period, it should not be reissued or referred to in the report on the financial statements of the current period. In these circumstances, the accountant should comply with the compilation or review standards in SSARS No. 1 [section 100] (or perform an audit) and report accordingly on the financial statements of the prior period. ~~(However, see also paragraphs .34 to .36 concerning reporting during the transition period.)~~ [Footnote renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005.]

1. For purposes of this ~~Statement~~ ***section***, reference to generally accepted accounting principles includes, where applicable, a comprehensive basis of accounting other than generally accepted accounting principles as defined in paragraph .04 of AR section 100. Disclosure of the basis of accounting should be made when a comprehensive basis of accounting other than generally accepted accounting principles is used.

[2] [Deleted to reflect the incorporation of material into relevant sections of the Statements on Standards for Accounting and Review Services.]

[1] [Footnote deleted by the issuance of Statement on Standards for Accounting and Review Services No. 9, November 2002.]

~~9. Paragraphs .19–.22 provide guidance to the accountant engaged to compile financial statements that omit substantially all the disclosures required by GAAP or OCBOA.~~

~~ance on the statements. (The accountant might consider it necessary to perform other accounting services to compile the financial statements. See paragraph .08.)~~

Review of financial statements. A service, the objective of which is to express limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with GAAP. ~~Performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements for them to be in conformity with GAAP or, if applicable, with OCBOA. (The accountant might consider it necessary to compile the financial statements or to perform other accounting services to enable him or her to perform a review. See paragraph .37.)~~

~~The objective of a review differs significantly from the objective of a compilation. The inquiry and analytical procedures performed in a review should provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements. No expression of assurance is contemplated in a compilation.~~

~~The objective of a review also differs significantly from the objective of an audit of financial statements in accordance with generally accepted auditing standards (GAAS). The objective of an audit is to provide a reasonable basis for expressing an opinion regarding the financial statements taken as a whole. A review does not provide a basis for the expression of such an opinion because a review does not contemplate obtaining an understanding of internal control or assessing control risk; tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter through inspection, observation, or confirmation; and certain other procedures ordinarily performed during an audit. A review may bring to the accountant's attention significant matters affecting the financial statements, but it does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit.~~

Compilation of Financial Statements

Objective of a Compilation Engagement

.06 The objective of a compilation engagement is to present in the form of financial statements, information that is the representation of management (owners) without undertaking to express any assurance on the financial statements.

~~.06~~ *.07* Paragraphs ~~.07~~ *.08*–~~.10~~ *.11* are applicable to a compilation of financial statements, whenever the accountant—

- Is engaged to report on compiled financial statements.
- Submits financial statements to a client that are or reasonably might be expected to be used by a third party.
- Submits financial statements to a client that are not expected to be used by a third party.

Limitations of a Compilation Engagement

.12 A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Therefore, a compilation does not provide a basis for expressing any level of assurance on the financial statements being compiled.

Review of Financial Statements

Objective of a Review Engagement

.28 The objective of a review engagement is to express limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with GAAP.

Review Performance Requirements

~~.26~~ *.29* ~~Paragraphs .27 through .48 provide additional guidance applicable to a review of financial statements.~~ *In order to obtain a reasonable basis for the expression of limited assurance, the accountant must*

- *apply analytical procedures to the financial statements, as discussed in paragraphs .36–.37 of AR section 100.*
- *make inquiries of management and, when deemed appropriate, other company personnel, as discussed in paragraph .38 of AR section 100.*
- *obtain representations from management for all financial statements and periods covered by the accountant's review report, as discussed in paragraphs .39– .42 of AR section 100.*

~~Procedures for conducting a review of financial statements generally are limited to analytical procedures, and inquiries. The accountant performs these procedures to obtain a basis for communicating whether he or she is aware of any material modifications that should be made to the financial statements for them to be in conformity with generally accepted accounting principles.~~

.30 The *analytical and other procedures performed and the* specific inquiries made ~~and the analytical and other procedures performed~~ should be tailored to the engagement based on the accountant's knowledge of the entity's business. For example, if the accountant becomes aware of a significant change in the entity's operations, the accountant may consider making additional inquiries, employing additional analytical procedures, or both.

~~.27~~ *.31* ~~A review does not contemplate obtaining an understanding of internal control or assessing control risk,; assessing fraud risks,; tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter performance of procedures designed to detect material misstatements due to fraud or illegal acts, and certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit. However,~~ *During the performance of the review procedures,* the accountant may become aware that information coming to his or her attention is incorrect, incomplete, or otherwise unsatisfactory~~. If any evidence or information comes to the accountant's attention regarding~~ *or that* fraud or an illegal act ~~that~~ may have occurred~~,~~. ~~t~~*T*he accountant should request that management consider the effect of the*se* matters on the financial statements. Additionally, the accountant should consider the effect of the*se* matter*s* on his or her review report. In circumstances where the accountant believes the financial statements are materially misstated, the accountant should perform ~~the~~ additional procedures deemed necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles. (See paragraph ~~.46~~*.51)* for guidance when an accountant is unable to complete a review and paragraphs ~~.51~~*.56*– ~~.53~~*.58* for the accountant's responsibilities when he or she is aware of departures from generally accepted accounting principles.)

Limitations of a Review Engagement

.32 A review differs significantly from an audit of financial statements in which the auditor provides reasonable assurance that the financial statements, taken as a whole, are free of material misstatement. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, a review does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit. Therefore, a review provides only limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with GAAP.

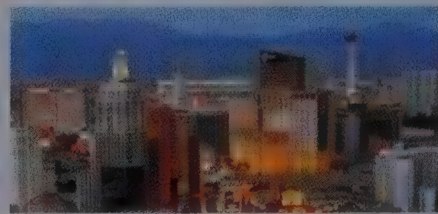
Analytical Procedures

~~.31~~*.36 In a review engagement,* ~~The~~ *the* accountant ~~should~~ *must* apply analytical procedures to the financial statements. ***The purpose of analytical procedures is*** to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a material misstatement. Analytical procedures ~~should~~ include:

- Developing expectations by identifying and using plausible relationships that are reason-

(continued on page 102)

AICPA conferences



AICPA Practitioners Symposium

Caesars Palace
Las Vegas, NV

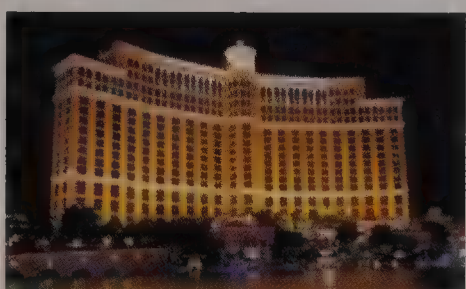
May 5-7, 2008

Pre-Conference Workshops:
Sunday, May 4, 2008
CPE Credits: 24.5 (main conference)
up to 10.5 (optionals)

Conference Highlights:

- Keynote: Rebecca Ryan on Staffing Your Firm for the Future
- Best Practices to Improve Your Firm
- PCPS Gala Reception is back

AICPA Tax Strategies for High Income Individuals



Bellagio
Las Vegas, NV

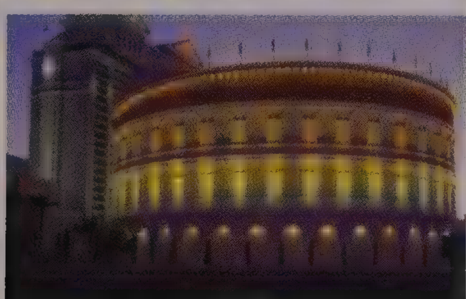
May 8-9, 2008

Pre-Conference Workshops:
Sunday, May 7, 2008
CPE Credits: 18 (main conference),
up to 8 (optionals)

Conference Highlights:

- Keynote Speaker, Chairman Christopher Cox, Securities and Exchange Commission
- Keynote presentations by: Robert Herz and Mark Weinberger
- Pass Through Entity Update
- Fair Market Value in Wealth Preservation

AICPA/AAML National Conference on Divorce



Caesars Palace
Las Vegas, NV

May 8-9, 2008

Pre-Conference Workshops:
Sunday, May 7, 2008
CPE Credits: 17 (main conference),
up to 3 (optionals)

Conference Highlights:

- BV Standards
- Case Law Updates
- Ethical Conundrums
- Asset or Income-Double Dip...Concept of Income in Divorce

AICPA Banking School

© Charlottesville/Albemarle Convention & Visitors Bureau, www.SoVeryVirginia.com

University of Virginia,
McIntire School of Commerce
Charlottesville, VA

May 11-16, 2008

CPE Credits: 40

Conference Highlights:

- Superior instruction on banking operations and accounting
- Features bank simulation, hands-on training
- Sessions on the Risk Assessment Standards
- Affect of real estate on the financial industry

ably expected to exist based on the accountant's understanding of the entity and the industry in which the entity operates.

- Comparing recorded amounts, or ratios developed from recorded amounts, to expectations developed by the accountant.

See Appendix I [paragraph ~~.92~~ *.105*] for examples of analytical procedures an accountant may consider performing when conducting a review of financial statements.

Subsequent and intervening paragraphs and footnotes are renumbered.

APPENDIX C

Compilation of Financial Statements–Illustrative Engagement Letter

~~.86~~ *.99*

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the annual [*and interim, if applicable*] balance sheet and related statements of income, retained earnings, and cash flows of XYZ Company for the year 20XX.

We will compile the financial statements and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. ~~A compilation is limited to presenting, in the form of financial statements, information that is the representation of management.~~ ***The objective of a compilation is to present in the form of financial statements, information that is the representation of management (owners) without undertaking to express any assurance on the financial statements.*** ~~We will not audit or review the financial statements and, accordingly, will not express an opinion or any other form of assurance on them.~~

A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Therefore, a compilation does not provide a basis for expressing any level of assurance on the financial statements being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures, that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

As part of our engagement, we will also (list any nonattest services to be performed, if applicable, such as income tax preparation and bookkeeping services).

You are responsible for:

a. Making all management decisions and performing all management functions;

b. Designating an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;

c. Evaluating the adequacy and results of the services performed;

d. Accepting responsibility for the results of the services; and

e. Establishing and maintaining internal contro~~ls~~, including monitoring ongoing activities.

If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services …

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.*

Sincerely yours,

____

[*Signature of accountant*]

Acknowledged:
XYZ Company

____

President

____

Date

*Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning, "If the foregoing…" and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement…"

APPENDIX D

Compilation of Financial Statements Not Intended for Third Party Use–Illustrative Engagement Letter

~~.87~~ *.100*

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the [*monthly, quarterly, or other frequency*] financial statements of XYZ Company for the year 20XX.

We will compile the financial statements in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. ~~A compilation is limited to presenting, in the form of financial statements, information that is the representation of management.~~ ***The objective of a compilation engagement is to present in the form of financial statements, information that is the representation of management (owners) without undertaking to express any assurance on the financial statements.*** ~~We will not audit or review the financial statements and, accordingly, will not express an opinion or any other form of assurance on them.~~

A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Therefore, a compilation does not provide a basis for expressing any level of assurance on the financial statements being compiled.

The financial statements will not be accompanied by a report. Based upon our discussions with you, these statements are for management's use only and are not intended for third-party use.

Material departures from generally accepted accounting principles (GAAP) ~~or other comprehensive basis of accounting (OCBOA)~~ may exist and the effects of those departures, if any, on the financial statements may not be disclosed. In addition substantially all disclosures required by GAAP ~~or OCBOA~~ may be omitted. (The accountant may wish to identify known departures.) Notwithstanding these limitations, you represent that you have knowledge about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements that allows you to place the financial information in the proper context. Further, you represent and agree that the use of the financial statements will be limited to members of management with similar knowledge.

The financial statements are intended solely for the information and use of [*include list of specified members of management*] and are not intended to be and should not be used by any other party—[*optional*].

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our compilation procedures, that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures, regarding illegal acts that may have occurred unless they are clearly inconsequential.

We are not independent with respect to [*name of entity*] [*if applicable*].

As part of our engagement, we will also (list any nonattest services to be provided, if applicable, such as income tax preparation and bookkeeping services).

You are responsible for:

a. Making all management decisions and performing all management functions;

b. Designating an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;

c. Evaluating the adequacy and results of the services performed;

d. Accepting responsibility for the results of the services; and

e. Establishing and maintaining internal control~~s~~, including monitoring ongoing activities.

The other data accompanying the financial statements are presented only for supplementary analysis purposes and will be compiled from information that is the representation of management, without audit or review, and we do not express an opinion or any other form of assurance on such data—[*if applicable*].

Our fees for these services ...

Should you require financial statements for third-party use, we would be pleased to discuss with you the requested level of service. Such engagement would be considered separate and not deemed to be part of the services described in this engagement letter.

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.*

Sincerely yours,

____

[*Signature of accountant*]

Accepted and agreed to:
XYZ Company

____

Title

____

Date

Subsequent and intervening paragraphs and footnotes are renumbered.

APPENDIX E

Review of Financial Statements–Illustrative Engagement Letter

~~.88~~*.101*

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will review the financial statements of XYZ Company as of December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. ***The objective of a review engagement is to express limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in accordance with generally accepted accounting principles.*** ~~We will not perform an audit of such financial statements, the objective of which is the expression of an opinion regarding the financial statements taken as a whole, and, accordingly, we will not express such an opinion on them.~~

A review differs significantly from an audit of financial statements, in which the auditor provides reasonable assurance that the financial statements, taken as a whole, are free of material misstatement. A review ~~consists primarily of inquiries of company personnel and analytical procedures applied to financial data. A review~~ does not contemplate obtaining an understanding of ***the entity's*** internal control ~~or assessing control risk,~~***; assessing fraud risk;*** tests of accounting records ~~and responses to inquiries~~ by obtaining ~~corroborating evidential matter~~ ***sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images);*** ~~, and certain~~ ***and*** other procedures ordinarily performed ~~during~~ ***in*** an audit. ~~Thus~~***Accordingly***, a review does not provide assurance that we will become aware of all significant matters that would be disclosed in an audit. ***Therefore, a review provides only limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles.***

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our review procedures, that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

As part of our engagement, we will also (list any nonattest services to be provided, if applicable, such as income tax preparation and bookkeeping services).

You are responsible for:

a. Making all management decisions and performing all management functions;

b. Designating an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;

c. Evaluating the adequacy and results of the services performed;

d. Accepting responsibility for the results of the services; and

e. Establishing and maintaining internal control~~s~~, including monitoring ongoing activities.

As part of our review procedures, we will require certain written representations from management about the financial statements and matters related thereto.

If, for any reason, we are unable to complete our review of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services. . . .

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

____

[*Signature of accountant*]

Acknowledged:
XYZ Company

____

President

____

Date

7. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008. Early application is permitted.

Amendment to AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.04)—Definitions of Those Charged with Governance, Management, and Third Parties

8. This amendment revises the definition of *third parties* in paragraph .04 of AR section 100 to clarify that the phrase "who are knowledgeable about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of financial statements" applies to "members of management." In addition, this amendment introduces definitions of *those charged with governance* and *management.* New language is shown in boldface italics. Note that only those definitions in paragraph .04 of AR section 100 that are revised or added as a result of this amendment are reflected below. The revisions made pursuant to paragraphs 1 and 6 of this proposed Statement on Standards for Accounting and Review Services are not reflected below. All other definitions are unchanged.

DEFINITIONS

.04 Certain terms are defined for purposes of this section as follows.

Those charged with governance. ***The person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. In some cases, those charged with governance are responsible for approving the entity's***

(continued on page 104)

*Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning, "If the foregoing..." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement..."

financial statements (in other cases, management has this responsibility). In some entities, governance is a collective responsibility that may be carried out by a board of directors, a committee of the board of directors, a committee of management, partners, equivalent persons, or some combination thereof. Those charged with governance are specifically excluded from management, unless they perform management functions as defined below.

Management. ***The person(s) responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management is responsible for the financial statements, including designing, implementing, and maintaining effective internal control over financial reporting.***

Third party. All ~~parties~~***persons, including those charged with governance***, except for ***those*** members of management ***as defined above.*** ~~who are knowledgeable about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of financial statements~~.[4]

9. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008. Early application is permitted.

Amendment to AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.36 and .89)—Dating of the Management Representation Letter

10. This amendment revises paragraphs .36 and .89 of AR section 100 to state that because (1) review procedures include obtaining representations from management for all financial statements and periods covered by the accountant's review report and (2) the accountant's review report should be dated as of the completion of the accountant's review procedures as well as the fact that the accountant is concerned with events occurring through the date of the review report that may require adjustment to or disclosure in the financial statements, management's representations should be made as of the date of the accountant's review report.

Management Representation~~s~~ *Letter*

~~.36~~***.41 In a review engagement, the accountant must obtain representations from management for all financial statements and periods covered by the accountant's review report. Because the accountant is concerned with events occurring through the date of the report that may require adjustment to or disclosure in the financial statements, management's representations set forth in the management representation letter should be made as of the date of the accountant's review report. The accountant need not be in physical receipt of the management representation letter as***

4. The accountant may wish to specify those members of management. See Appendix D [paragraph ~~.87~~ *100*], "Compilation of Financial Statements Not Intended For Third-Party Use – Illustrative Engagement Letter."

General	
Condition	Illustrative Examples
The impact of a new accounting principle is not known.	We have not completed the process of evaluating the impact that will result from adopting Financial Accounting Standards Board (FASB) Statement No. [*XXX, Name*], as discussed in Note [*X*]. The company is therefore unable to disclose the impact that adopting FASB Statement No. [*XXX*] will have on its financial position and the results of operations when such statement is adopted.
There is justification for a change in accounting principles.	We believe that [*describe the newly adopted accounting principle*] is preferable to [*describe the former accounting principle*] because [*describe management's justification for the change in accounting principles*].
Financial circumstances are strained, with disclosure of management's intentions and the entity's ability to continue as a going concern.	Note [*X*] to the financial statements discloses all of the matters of which we are aware that are relevant to the company's ability to continue as a going concern, including significant conditions and events, and management's plans.
The possibility exists that the value of specific significant long-lived assets or certain identifiable intangibles may be impaired.	We have reviewed long-lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable and have appropriately recorded the adjustment.
The entity has a variable interest in another entity.	Variable interest entities (VIEs) and potential VIEs and transactions with VIEs and potential VIEs have been properly recorded and disclosed in the financial statements in accordance with GAAP. We have considered both implicit and explicit variable interests in (*a*) determining whether potential VIEs should be considered VIEs, (*b*) calculating expected losses and residual returns, and (*c*) determining which party, if any, is the primary beneficiary. We have provided you with lists of all identified variable interests in (*a*) VIEs, (*b*) potential VIEs that we considered but judged not to be VIEs, and (*c*) entities that were afforded the scope exceptions of FASB Interpretation (FIN) No. 46R, *Consolidation of Variable Interest Entities— An Interpretation of ARB No. 51*. We have advised you of all transactions with identified VIEs, potential VIEs, or entities afforded the scope exceptions of FIN No. 46R. We have made available all relevant information about financial interests and contractual arrangements with related parties, de facto agents, and other entities, including but not limited to, their governing documents, equity and debt instruments, contracts, leases, guarantee arrangements, and other financial contracts and arrangements. The information we provided about financial interests and contractual arrangements with related parties, de facto agents, and other entities includes information about all transactions, unwritten understandings, agreement modifications, and written and oral side agreements. Our computations of expected losses and expected residual returns of entities that are VIEs and potential VIEs are based on the best information available and include all reasonably possible outcomes. Regarding entities in which the company has variable interests (implicit and explicit), we have provided all information about events and changes in circumstances that could potentially cause reconsideration about whether the entities are VIEs or whether the company is the primary beneficiary or has a significant variable interest in the entity. We have made and continue to make exhaustive efforts to obtain information about entities in which the company has an implicit or explicit interest but that were excluded from complete analysis under FIN No. 46R due to lack of essential information to determine one or more of the following: whether the entity is a VIE, whether the company is the primary beneficiary, or the accounting required to consolidate the entity.
The work of a specialist has been used by the entity	We agree with the findings of specialists in evaluating the [*describe assertion*] and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on the independence or objectivity of the specialists.

Assets	
Condition	Illustrative Examples
Cash Disclosure is required of compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements.	Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements have been properly disclosed.
Financial Instruments Management intends to and has the ability to hold to maturity debt securities classified as held-to-maturity.	Debt securities that have been classified as held-to-maturity have been so classified due to the company's intent to hold such securities to maturity and the company's ability to do so. All other debt securities have been classified as available-for-sale or trading.
Management considers the decline in value of debt or equity securities to be temporary.	We consider the decline in value of debt or equity securities classified as either available-for-sale or held-to-maturity to be temporary.
Management has determined the fair value of significant financial instruments that do not have readily determinable market values.	The methods and significant assumptions used to determine fair values of financial instruments are as follows: [*describe methods and significant assumptions used to determine fair values of financial instruments*]. The methods and significant assumptions used result in a measure of fair value appropriate for financial statement measurement and disclosure purposes.
There are financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk.	The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the financial statements: 1. The extent, nature, and terms of financial instruments with off-balance-sheet risk 2. The amount of credit risk of financial instruments with off-balance-sheet risk and information about the collateral supporting such financial instruments 3. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments
Receivables Receivables have been recorded in the financial statements.	Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.
Inventories Excess or obsolete inventories exist.	Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value.
Investments There are unusual considerations involved in determining the application of equity accounting.	[*For investments in common stock that are either nonmarketable or of which the entity has a 20 percent or greater ownership interest, select the appropriate representation from the following:*] • The equity method is used to account for the company's investment in the common stock of [*investee*] because the company has the ability to exercise significant influence over the investee's operating and financial policies. • The cost method is used to account for the company's investment in the common stock of [*investee*] because the company does not have the ability to exercise significant influence over the investee's operating and financial policies.
Deferred Charges Material expenditures have been deferred.	We believe that all material expenditures that have been deferred to future periods will be recoverable.
Deferred Tax Assets A deferred tax asset exists at the balance-sheet date.	The valuation allowance has been determined pursuant to the provisions of FASB Statement No. 109, *Accounting for Income Taxes*, including the company's estimation of future taxable income, if necessary, and is adequate to reduce the total deferred tax asset to an amount that will more likely than not be realized. [*Complete with appropriate wording detailing how the entity determined the valuation allowance against the deferred tax asset.*] or A valuation allowance against deferred tax assets at the balance-sheet date is not considered necessary because it is more likely than not the deferred tax asset will be fully realized.

of the date of the accountant's review report provided that management has acknowledged that they will sign the representation letter without modification, and it is received prior to the date the report is released. The ~~written representations~~ ***management representation letter*** should be addressed to the accountant. ~~Because the accountant is concerned with events occurring through the date of the report that may require adjustment to or disclosure in the financial statements, the representations should be made as of a date no earlier than the date of the accountant's report.~~ The letter should be signed by those members of management whom the accountant believes are responsible for and knowledgeable, directly or through others in the organization, about the matters covered in the representation letter. Normally, the chief executive officer and chief financial officer or others with equivalent positions in the entity should sign the representation letter. If the current management was not present during all periods covered by the accountant's report, the accountant should nevertheless obtain written representations from current management on all such periods.

APPENDIX F

Review of Financial Statements—Illustrative Representation Letter

~~.89~~*.102*

A review of financial statements consists principally of inquiries of company personnel and analytical procedures applied to financial data. As part of a review of financial statements, the accountant is required to obtain a written representation from his or her client to confirm the oral representations made to the accountant. The introductory paragraph should specify the financial statements and periods covered by the accountant's review report~~, for example, "balance sheets of XYZ Company as of December 31, 20X1 and 20X0, and the related statements of income and retained earnings, and cash flows for the years then ended."~~.

If matters exist that should be disclosed to the accountant, they should be indicated by listing them following the representation. For example, if an event subsequent to the date of the balance sheet has been disclosed in the financial statements, the subsequent events paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in Note X to the financial statements, no events have occurred. . . ." Similarly, in appropriate circumstances, item 4 could be modified as follows: "The company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except for our plans to dispose of Segment A, as disclosed in Note X to the financial statements, which are discussed in the minutes of the December 7, 20X1, meeting of the board of directors."

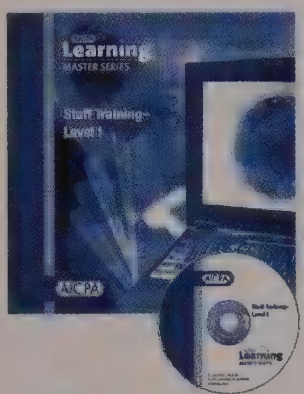
The following representation letter is included for illustrative purposes only. The accountant may decide, based on the circumstances of the review engagement or the industry in which the entity operates, that other matters should be specifically included in the letter or that some of the represen-

(continued on page 108)

AICPA marketplace 2008

Focus on Practice Development

Staff Training – Level 1



738410JA04
Regular **$368.75**
AICPA Member **$295.00**

With the Staff Training CD-ROM, you have a simple and cost-effective way to ensure your staff receives the training it needs. Level I contains eight individual courses on audit areas typically assigned to junior staff.

Objectives

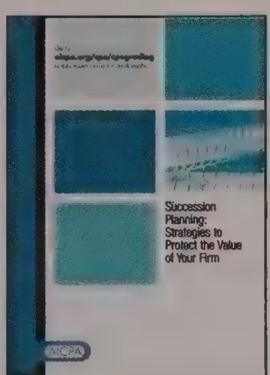
- Maintain professional skepticism
- Evaluate internal controls
- Assess audit risk, materiality and financial statement assertion
- Apply auditing standards regarding fraud
- Perform audit tests on cash, fixed assets, accounts payable, debt and other liabilities
- Prepare audit documentation

Prerequisite: One to ten months of public accounting experience
NASBA Field of Study: Auditing
Level: Basic
Recommended CPE Credit: 20

Courses

- *Professional Skepticism and Maintaining the Public Trust*
- *Fraud Detection*
- *Risk Assessment and Introduction to Internal Contro*
- *Audit Documentation*
- *Auditing Cash*
- *Auditing Fixed Assets*
- *Auditing Accounts Payable and Accrued Expenses*
- *Auditing Long-Term Debt*

Succession Planning: Strategies to Protect the Value of Your Firm



DVD/Manual
180321JA04
Regular **$236.25**
AICPA Member **$189.00**

More CPA firm ownership will change hands this decade than in any previous decade. Knowing what other CPA firms are doing to position for succession and what best practices they are implementing has become essential.

Objectives:

- Understand what actions to take to best position your firm for succession or transition to new leadership
- Understand how to avoid the most common pitfalls encountered during succession
- Be able to put together an action plan to best position your firm for success whether it is being sold, merged, or transferred to new leadership

Prerequisite: Leadership responsibility within a CP
NASBA Field of Study: Business Management & Organization
Level: Basic
Recommended CPE Credit: 10

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Stay plugged in to what's happening and earn CPE credit right from your desktop.

Employee Benefit Plans Strategic Briefing 4/23/08 • 1-3 pm ET Recommended CPE Credit: 2	**Report Leadership: Online Corporate Reporting and Executive Compensation Reporting** 5/15/08 • 12-1:15 pm ET Recommended CPE Credit: 1	**Not-For-Profit Strategic Briefi** 6/5/08 • 1-3 pm ET Recommended CPE Credit: 2

For more information or to register, log on to www.cpa2biz.com/webcasts

*** CPE Credit**

Credits for AICPA CPE self-study courses are based on a 50-minute hour in compliance with the *Statement on Standards for Continuing Prof Education (CPE) Programs* issued jointly by the AICPA and NASBA. For more information, visit **www.cpa2biz.com**.

tations included in the illustrative letter are not necessary.

(Date[1])

(To the Accountant)

We are providing this letter in connection with your review of the (identification of financial statements~~, for example, balance sheets and related statements of income and retained earnings, and cash flows~~) of (name of entity) as of (dates, for example, December 31, 20X1 and December 31, 20X2) and for the (periods of review, for example, for the years then ended) for the purpose of expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles. We confirm that we are responsible for the fair presentation in the financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person using the information would be changed or influenced by the omission or misstatement.[2]

We confirm, to the best of our knowledge and belief, [as of (the date of the accountant's review report)] the following representations made to you during your review.

1. The financial statements referred to above are fairly presented in conformity with generally accepted accounting principles.
2. We have made available to you all:
   a. Financial records and related data.
   b. Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.
4. We acknowledge our responsibility to prevent and detect fraud.
5. We have no knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees, or others.
6. We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.
7. There are no material losses (such as from obsolete inventory or purchase or sales commit-

Liabilities	
Condition	Illustrative Examples
Debt Short-term debt could be refinanced on a long-term basis and management intends to do so.	The company has excluded short-term obligations totaling $[*amount*] from current liabilities because it intends to refinance the obligations on a long-term basis. [*Complete with appropriate wording detailing how amounts will be refinanced as follows:*] ▪ The company has issued a long-term obligation [*debt security*] after the date of the balance sheet but prior to the issuance of the financial statements for the purpose of refinancing the short-term obligations on a long-term basis. ▪ The company has the ability to consummate the refinancing, by using the financing agreement referred to in Note [*X*] to the financial statements.
Tax-exempt bonds have been issued.	Tax-exempt bonds issued have retained their tax-exempt status.
Taxes Management intends to reinvest undistributed earnings of a foreign subsidiary.	We intend to reinvest the undistributed earnings of [*name of foreign subsidiary*].
Contingencies Estimates and disclosures have been made of environmental remediation liabilities and related loss contingencies.	Provision has been made for any material loss that is probable from environmental remediation liabilities associated with [*name of site*]. We believe that such estimate is reasonable based on available information and that the liabilities and related loss contingencies and the expected outcome of uncertainties have been adequately described in the company's financial statements.
Agreements may exist to repurchase assets previously sold.	Agreements to repurchase assets previously sold have been properly disclosed.
Pension and Postretirement Benefits An actuary has been used to measure pension liabilities and costs.	We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.
There is involvement with a multiemployer plan.	We are unable to determine the possibility of a withdrawal liability in a multiemployer benefit plan. or We have determined that there is the possibility of a withdrawal liability in a multiemployer plan in the amount of $[*XX*].
Postretirement benefits have been eliminated.	We do not intend to compensate for the elimination of postretirement benefits by granting an increase in pension benefits. or We plan to compensate for the elimination of postretirement benefits by granting an increase in pension benefits in the amount of $[*XX*].
Employee layoffs that would otherwise lead to a curtailment of a benefit plan are intended to be temporary.	Current employee layoffs are intended to be temporary.
Management intends to either continue to make or not make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost, or has expressed a substantive commitment to increase benefit obligations.	We plan to continue to make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost. or We do not plan to make frequent amendments to its pension or other postretirement benefit plans.

Equity	
Condition	Illustrative Example
There are capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements.	Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements have been properly disclosed.

1. This date should be the date that ***the client presents and signs*** the letter ~~is presented and signed by the client~~. In no event should the letter be presented and signed prior to the ~~completion of the review~~ ***date of the accountant's review report.***

2. The qualitative discussion of materiality used in this letter is adapted from Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information.*

Income Statement	
Condition	Illustrative Examples
There may be a loss from sales commitments.	Provisions have been made for losses to be sustained in the fulfillment of or from inability to fulfill any sales commitments.
There may be losses from purchase commitments.	Provisions have been made for losses to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of prevailing market prices.
Nature of the product or industry indicates the possibility of undisclosed sales terms.	We have fully disclosed to you all sales terms, including all rights of return or price adjustments and all warranty provisions.

ments) that have not been properly accrued or disclosed in the financial statements.

8. There are no:

a. Violations or possible violations of laws or regulations, whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency

b. Unasserted claims or assessments that our lawyer has advised us are probable of assertion that must be disclosed in accordance with Financial Accounting Standards Board (FASB) Statement No. 5 [AC section C59], *Accounting for Contingencies.*[3]

c. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB Statement No. 5

9. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral, except as disclosed to you and reported in the financial statements.

10. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

11. The following have been properly recorded or disclosed in the financial statements:

a. Related party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.

b. Guarantees, whether written or oral, under which the company is contingently liable.

c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. [Significant estimates are estimates at the balance sheet date that could change materially with the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.]

[*Add additional representations that are unique to the entity's business or industry. See charts pages 104–109 for additional illustrative representations.*]

12. We are in agreement with the adjusting journal entries you have recommended, and they have been posted to the company's accounts. (if applicable)

13. To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.[4]

14. We have responded fully and truthfully to all inquiries made to us by you during your review.

____
(Name of Owner or Chief Executive Officer and Title)

____
(Name of Chief Financial Officer and Title, where applicable)

Representation letters ordinarily should be tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry. The following is a list of additional representations that may be appropriate in certain situations. This list is not intended to be all-inclusive. The accountant should consider the effects of pronouncements issued subsequent to the issuance of this section.

11. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008. Early application is permitted

Amendment to AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100)—An Entity's Ability to Continue as a Going Concern

12. Currently AR section 100 does not provide guidance with respect to an accountant's consideration of the entity's ability to continue as a going concern during the performance of compilation or review procedures. This amendment revises AR section 100 to include such guidance.

.69 During the performance of compilation or review procedures, evidence or information may come to the accountant's attention indicating that there may be an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being compiled or reviewed (hereinafter referred to as a reasonable period of time*). In those circumstances, the accountant should request that management consider the possible effects of the going concern uncertainty on the financial statements, including the need for related disclosure.*

.70 After management communicates to the accountant the results of its consideration of the possible effects on the financial statements, the accountant should consider the reasonableness of management's conclusions including the adequacy of the related disclosures, if applicable.

.71 If the accountant determines that management's conclusions are unreasonable or the disclosure of the uncertainty regarding the entity's ability to continue as a going concern is not adequate, he or she should follow the guidance in paragraphs .56–.58 of AR section 100 with respect to departures from generally accepted accounting principles.

.72 The accountant may emphasize an uncertainty about an entity's ability to continue as a going concern provided the uncertainty is disclosed in the financial statements. In such circumstances, the accountant should follow the guidance in paragraphs .54–.55 of AR section 100.

13. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008. Early application is permitted.

Amendment to AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100)—Subsequent Events

14. Currently AR section 100 does not provide guidance with respect to an accountant's consideration of subsequent events in a compilation or review engagement. This amendment revises AR section 100 to include such guidance.

.73 Events or transactions sometimes occur subsequent to the balance sheet date, but prior to management's issuance of financial statements that have a material effect on the financial statements, and therefore require adjustment to or disclosure in the statements. These occurrences hereinafter are referred to as "subsequent events."

.74 Evidence or information that a subsequent event that has a material effect on the compiled or reviewed financial statements has occurred may come to the accountant's attention in the following ways:

(a) During the performance of compilation or review procedures

(b) Subsequent to the date of the accountant's compilation or review report but prior to the release of the report[37]

In either case, the accountant should request that management consider the possible effects on the financial statements including the adequacy of

3. If management has not consulted a lawyer regarding litigation, claims, and assessments, the representation might be worded as follows: We are not aware of any pending or threatened litigation, claims, or assessments or unasserted claims or assessments that are required to be accrued or disclosed in the financial statements in accordance with Financial Accounting Standards Board Statement No. 5 [AC section C59], *Accounting for Contingencies*, and we have not consulted a lawyer concerning litigation, claims, or assessments.

4. If the accountant "dual dates" his or her report, the accountant should consider whether obtaining additional representations relating to the subsequent event is appropriate.

37. For purposes of this section, with respect to compiled financial statements in which the accountant does not report, the submission of the compiled financial statements is the equivalent of the accountant's compilation or review report date.

(continued on page 110)

any related disclosure, if applicable.

.75 If the accountant determines that the subsequent event is not adequately accounted for in the financial statements or disclosed in the notes, he or she should follow the guidance in paragraphs .56–.58 of AR section 100, **Departures From Generally Accepted Accounting Principles.**

.76 Occasionally, a subsequent event has such a material impact on the entity that the accountant may wish to include in his or her compilation or review report an explanatory paragraph directing the reader's attention to the event and its effects. Such an emphasis of matter paragraph may be added, at the accountant's discretion, provided that the matter is disclosed in the financial statements. See paragraphs .54–.55 of AR section 100 for additional guidance with respect to emphasis of matter paragraphs.

15. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008. Early application is permitted.

Amendment to AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.70)—Supplementary Information

16. In paragraph .70 of AR section 100, which provides guidance on supplementary information, it is stated that "the review has been made primarily for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles." In order to clarify the guidance in Statements on Standards for Accounting and Review Services, the word *primarily* will be deleted from the paragraph. New language is shown in boldface italics; deleted language is shown by strikethrough.

~~.70~~ ***.83*** When the basic financial statements are accompanied by information presented for supplementary analysis purposes, the accountant should clearly indicate the degree of responsibility, if any, he or she is taking with respect to such information.

- When the accountant has reviewed the basic financial statements, an explanation should be included in the review report, or in a separate report on the other data. The report should state that the review has been made ~~primarily~~ for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles, and either
  a. The other data accompanying the financial statements are presented only for supplementary analysis purposes and have been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, and the accountant did not become aware of any material modifications that should be made to such data, or
  b. The other data accompanying the financial statements are presented only for supplementary analysis purposes and have not been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, but were compiled from information that is the representation of management, without audit or review, and the accountant does not express an opinion or any other form of assurance on such data.

When the accountant has compiled both the basic financial statements and other data presented only for supplementary analysis purposes, the compilation report should refer to the other data or the accountant can issue a separate report on the other data. If a separate report is issued, the report should state that the other data accompanying the financial statements are presented only for supplementary analysis purposes and that the information has been compiled from information that is the representation of management, without audit or review, and the accountant does not express an opinion or any other form of assurance on such data.

17. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008. Early application is permitted.

Amendment to AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2)—Analytical Procedures in a Review Engagement

18. This amendment incorporates guidance with respect to analytical procedures in a review engagement as an exhibit to the Codification of Statements on Standards for Accounting and Review Services. New language is shown in boldface italics.

Exhibit A

Analytical Procedures in a Review Engagement

Notice to Readers

The purpose of the documentation guidance contained in this exhibit is to illustrate how an accountant might document expectations in a review engagement. The examples are presented for illustrative purposes only and should not be considered to represent either minimum or maximum documentation requirements.

This exhibit is an other compilation and review publication *as defined in AR section 50,* Standards for Accounting and Review Services. Other compilation and review publications *have no authoritative status; however, they may help the accountant understand and apply SSARSs. If an accountant applies the guidance included in an* Other Compilation and Review Publication, *the accountant should be satisfied that, in his or her judgment, it is both appropriate and relevant to the circumstances of the subject engagement. This publication was reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate.*

Expectations

Forming an expectation is an integral phase of the analytical procedure process. Expectations are the accountant's predictions of recorded amounts or ratios developed from recorded amounts. In performing analytical procedures, the accountant develops the expectation in such a way that a material difference between the expectation and the recorded amount or ratio is indicative of a possible misstatement and, therefore, the accountant should obtain explanations for the difference (for example, an unusual event occurred). Expectations are developed by identifying plausible relationships (for example, store square footage and retail sales) that are reasonably expected to exist based on the accountant's understanding of the client and the industry in which the client operates. The accountant selects from a variety of data sources to form expectations. For example, the accountant may use prior-period information (adjusted for expected changes), management's budgets or forecasts, industry data, or nonfinancial data. Additionally, information that is developed when an accountant compiles interim financial statements can be utilized by the accountant in developing expectations associated with the review of financial statements.

An accountant cannot, under any circumstances, perform effective analytical procedures without first developing expectations related to the results of those analytical procedures. Expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements ordinarily are less encompassing than those developed in an audit.

Pursuant to paragraph .45 of AR section 100, the accountant should document expectations and factors considered in the development of those expectations where significant expectations are not otherwise readily determinable from the documentation of the work performed.

The following are examples of how an accountant can document expectations. These examples are not intended to be all inclusive.

Example 1 – Expected increase in revenue

An accountant is engaged to review the financial statements of a company that manufactures components that are utilized by other companies in customizing vehicles for use by the United States military. Because of various conflicts occurring in the world and the United States' role in those conflicts, the accountant reasonably expects sales to increase. Using his or her knowledge of the client, the client's business, and the industry in which the client operates, the accountant expects a 10 percent to 15 percent increase in sales. Further, the accountant concludes that receivables should increase, and that loans payable and interest expense would also increase because the client would need to borrow money to fund the additional production.

Sample documentation
Teemickmag Military Supply Company
Analytical Procedures
For the year ended December 31, 20XX

Expectations

The following are factors that should affect the relationship between current and prior year amounts:

- *Increase in military spending by the government due to world events should result in an increase in sales. Expected increase is between 10 percent and 15 percent. The accountant expects a similar increase in accounts receivable.*
- *Because of an increase in production of military vehicles, the company had to borrow additional funds. Therefore, expected increase in loans payable and interest expense is between 10 percent and 15 percent.*
- *No significant change in either days sales in inventory or inventory turnover is expected. Although a build-up in inventory is expected, that build-up is not expected to correspond with the increase in sales because the vehicles are expected to be sold near the date of completion. Any change greater than 5 percent will be subjected to additional inquiries.*

Balance sheets and income statements are available for the current year and the two years prior to the current year.

Trend analysis

	Current Year	Prior Year	Change	% Change
Sales	$2,500,000	$2,175,000	$325,000	14.94%
Cost of goods sold	1,780,000	1,566,000	214,000	13.67%
Gross margin	720,000	609,000		
Gross margin as a % of sales	28.80%	28.00%		
Selling expenses	230,000	184,000	46,000	25.00%
Interest expense	48,000	42,000	6,000	14.29%

Balance sheet ratio analysis

	Current Year	Prior Year	Two Years Prior
Accounts receivable, net	$1,100,000	$843,000	$703,000
Inventory	1,000,000	832,000	694,000
Loans payable	498,000	437,000	418,000

Days sales in receivables

Days sales in receivables = Accounts receivable, net at end of period / (Net sales / 365)

Current year days sales in receivables = $1,100,000 / ($2,500,000 / 365) = 161 days

Prior year days sales in receivables = $843,000 / ($2,175,000 / 365) = 141 days

The increase of 20 days sales in receivables (161 days – 141 days) represents a 14 percent increase. Because this increase is within the expected range, no further inquiry is necessary.

Days sales in inventory

Days sales in inventory = Inventory at the end of period / (Total cost of goods sold / 365)

Current year days sales in inventory = $1,000,000 / ($1,780,000 / 365) = 205 days

Prior year days sales in inventory = $832,000 / ($1,566,000 / 365) = 194 days

The increase of 11 days sales in inventory (205 days – 194 days) represents a 6 percent increase. Since this increase is greater than expected, the accountant should inquire of the client and document the reason for the unexpected increase.

Inventory turnover

Inventory turnover = Cost of goods sold / Average inventory

Current year inventory turnover = $1,780,000 / ($1,100,000 + 832,000 / 2) = 1.84 times

Prior year inventory turnover = $ 1,566,000 / ($832,000 + 694,000 / 2) = 2.05 times

The inventory turnover decreased 10 percent; therefore, since this decrease is greater than expected, the accountant should inquire of the client and document the reason for the unexpected decrease.

The above documentation would be adequate. Further, after performing the trend analysis, the accountant concludes that sales, costs of goods sold, and interest expensè are all "reasonable" given the expectations associated with these amounts. In addition, with respect to balance sheet accounts, the increase in loans payable is also reasonable (14 percent increase) when considered with the corresponding increase in interest expense and the expectation associated with the loan payable account; however, since selling expenses increased by 25 percent, the accountant should inquire of the client and document the reason for that unexpected increase (actual increase does not correspond to expected increase).

Example 2 – Expected decrease in revenue

An accountant is engaged to review the financial statements of a client that either owns or manages a shopping mall. Due to a poor economy, the mall lost tenants during the year; as such, the accountant reasonably expects revenue to decrease. Using his or her knowledge of the client, the client's business, and the industry in which the client operates, the accountant expects a 5 percent to 10 percent decrease in revenue during the year. Further, the accountant expects that general and administrative expenses should increase due to an increase in leasing and sales expenses and that management fees should decrease due to a decrease in tenants in the building.

Sample documentation
Pearl River Mall
Analytical Procedures
For the year ended December 31, 20XX

Expectations

The following are factors that should affect the relationship between current and prior year amounts:

- *Loss of tenants due to poor economy should result in a decrease in revenue. Expected decrease is between 5 percent and 10 percent.*
- *Because of the increased number of vacancies, general and administrative expenses are expected to increase because of an increase in leasing and sales expenses. Expected increase is between 5 percent and 10 percent (corresponds with the decrease in revenue).*
- *Because of the decrease in the number of tenants in the building, management fees are expected to decrease between 5 percent and 10 percent (corresponds with decrease in revenue).*

Balance sheets and income statements are available for the current year and the two years prior to the current year.

Trend analysis

	Current Year	Prior Year	Change	% Change
Tenant revenue	$7,223,000	$8,603,000	$(1,380,000)	(16.04)%
Costs and expenses:				
Management fees	339,000	387,000	(48,000)	(12.40)%
General and administrative	583,000	511,000	72,000	14.09 %

Similar balance sheet analytics should be performed as those performed in Example 1 above.

The above documentation would be adequate; however, the results of the analytical procedures do not agree with the documented expectations

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associated with those procedures. Therefore, the accountant should inquire and document why the decrease in tenant revenue, the decrease in management fees, and the increase in general and administrative expenses exceeded expectations.

Example 3 – No significant change in revenue or expenses expected

An accountant is engaged to review the financial statements of a small, privately held client in the candy store business. The accountant has performed a review of the financial statements of the candy store for each of the past five years with no significant change in revenue or expenses in any of those years. The accountant expects that trend to continue.

Sample documentation
Mom and Pop Candy Store
Analytical Procedures
For the year ended December 31, 20XX

Expectations

- *Based on discussions with the owner and manager, no significant changes from prior year amounts are expected.*
- *All increases and decreases greater than 5 percent will be subjected to additional inquiries.*

Trend analysis

	Current Year	*Prior Year*	*Change*	*% Change*
Sales	*$44,000*	*$ 39,000*	*$5,000*	*12.82%*
Cost of goods sold	*32,500*	*31,000*	*1,500*	*4.84%*
Gross margin	*11,500*	*8,000*		
Gross margin as a % of sales	*26.14%*	*20.51%*		
Operating expenses	*5,200*	*4,500*	*700*	*15.56%*
Net income	*6,300*	*3,500*		

Similar balance sheet analytics should be performed as those performed in Example 1 above.

The above documentation would be adequate; however, the results of the analytical procedures do not agree with the documented expectations associated with those procedures. Therefore, the accountant may deem it appropriate to inquire and document why sales increased by an amount greater than expected. In addition, the accountant should inquire as to why there was not a comparable increase in cost of goods sold. Also, the accountant should discuss with the owner and manager why there is a greater than expected increase in operating expenses and document the results of the discussion.

Example 4 – Expected Changes in Construction Contracts

An accountant is engaged to review the financial statements of a general construction contractor primarily engaged in the construction of commercial office buildings. The accountant has performed the review of this company's financial statements for several years and expects that the current project in process should yield a 5 percent gross profit margin consistent with similar projects in the past and in accordance with the initial project estimate.

Sample documentation

ABC Construction Contractors
Analytical Procedures
For the Year Ended December 31, 20XX

Expectations

- *Based upon discussions with the project manager, it is believed that the gross margin will be consistent with the 5 percent margin achieved in the past and in accordance with the initial project estimate.*
- *Any deviation in the margin greater than 1 percent will be subjected to additional inquiries.*

Trend analysis

Building Contract	*Current Year*	*Prior Year*	*$ Change*	*% Change*
Contract value	*$5.0 million*	*$5.0 million*		
Estimated costs at completion	*4.9 million*	*4.75 million*	*$150,000*	*3.15%*
Planned profit	*100,000*	*250,000*	*150,000*	*60.00%*
Costs incurred	*2.5 Million*	*$1.0 million*		
Profit recognized contract to date	*50,000*	*50,000*		

The above documentation indicates that the profit margin on the contract has slipped from 5 percent to 2 percent. Additionally, in accordance with the cost-to-cost method of percentage of completion accounting, it now appears that all of the contract profit was recognized in year one. This may indicate a potential error in the original estimate or a project that is quickly running over budget. The result may be a reversal of profits recognized in earlier periods under the percentage of completion method of contract revenue recognition or a potential loss contract. Further inquiry of management should be considered to discuss potential project issues that will negatively affect profit recognition in the financial statements.

This Statement titled Omnibus Statement on Standards for Accounting and Review Services - 2008 *was adopted unanimously by the assenting votes of the seven members of the Accounting and Review Services Committee.*

Note: *Statements on Standards for Accounting and Review Services (SSARSs) are issued by the AICPA Accounting and Review Services Committee (ARSC), the senior technical body of the institute designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity. Rule 202,* Compliance With Standards, *of the Institute's Code of Professional Conduct requires an AICPA member who performs either a compilation or a review (the accountant) to comply with standards promulgated by the ARSC. The accountant should have sufficient knowledge of the SSARSs to identify those that are applicable to his or her compilation or review and should be prepared to justify departures from the SSARSs.*

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Accounting Manager (Des Plaines, Illinois) wanted by nursing home. Responsible for developing accounting principles to analyze and establish financial data and reports. Conduct audit for management. Verify and evaluate entries in general ledgers. Supervise performances of cash flow and account reconciliation. Required Bachelors or equivalent in Accounting and 5 years experience in job offered or in any supervisor position in accounting. Masters in Accounting acceptable in lieu of Bachelors and 5 years experience requirements. Mail resumes to Jay Lewkowitz, Executive Director, Oakton Pavillion, 1660 Oakton Place, Des Plaines, IL 60018, ref#107-01142. No calls.

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Staff Accountant (New York, NY) - Analyze financial information and prepare financial reports to determine or maintain record of assets, liabilities, profit and loss, tax liability, or other financial activities. BA/MS or Foreign Equivalent in related field, plus related experience. Resume: Prajapati Associates, LLP, 545 Fifth Ave., Suite 400, New York, NY 10017.

Accounting Manager (New York, NY) - Analyze financial information and prepare financial reports to determine or maintain record of assets, liabilities, profit and loss, tax liability, or other financial activities. Analyze business operations, trends, costs, and revenues, financial commitments to project future revenues and expenses or to provide advice. BA/MS or foreign equivalent in related field, plus related experience. Resume: Prajapati Associates, LLP, 545 Fifth Ave., New York, NY 10017.

Accountant - Prepare, examine, analyze accounting records, financial statements, compute taxes, prepare tax-returns, analyze business operations, trends, costs, revenues; Review audits, prepare auditors statements; report to management regarding finances; establish table of accounts and assign entries to proper accounts; Develop, maintain, analyze budgets, prepare profit & loss statements; Develop record-keeping and accounting systems; prepare forms and manuals for accounting and book-keeping personnel; Survey operations for accounting needs; Advise management on accounting issues. Bachelors Degree with 2 years experience. Mail Resume: Niteen Hotels (NY) Corp., 215 West 34th St., New York, NY 10001.

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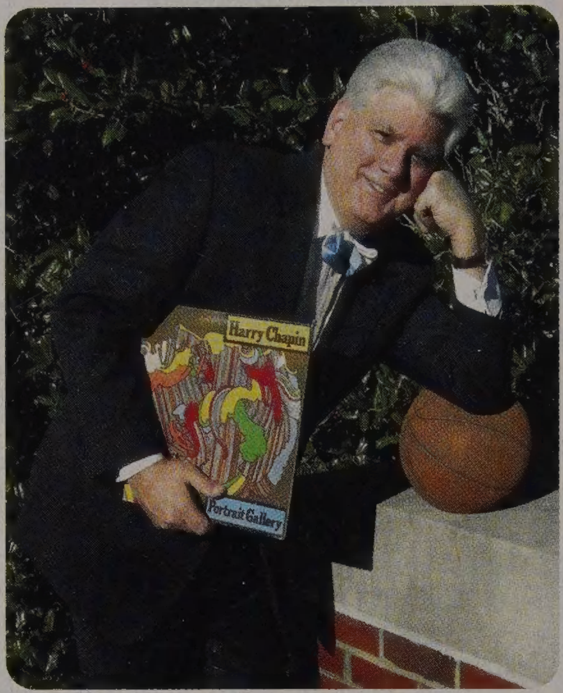
Next available issue is June, closing April 25th.

THE LAST WORD

I don many hats as a faculty member. At various points in my life, I've wanted to be a priest, coach, disc jockey, accountant, professor, taxi driver, bartender, musician, actor, paperback writer, talk show host and stand-up comic. My classes resemble (VH-1's) *Pop-Up Video*. I try being eclectic and colorful. Mixed into my lectures are music and movies and sports trivia and candy. Interspersing those things into the classes, I think, makes them more exciting.



C.J. Skender, CPA
Adjunct professor,
University of North Carolina at Chapel Hill and Duke University

I encourage students to climb the ladder of success and take their family and friends along, to not be afraid of failing, to express their gratitude to others often, to give something back, and to tell those closest to them that they love them. I preach that their reputation is their most valuable asset and wealth is measured not just by dollars and cents but by the people they have around them. I quote Harry Chapin to convey the importance of living each day to the fullest: "It's got to be the going not the getting there that's good."

I grew up in Harrisburg, Pa., in a first-generation college family. My father, an insurance man, once remarked that teachers have pretty nice lives. He passed away when I was in sixth grade. How my mom raised three kids still amazes me. We talk daily.

I relate to lines from songs. While working for Haskins & Sells, I kept hearing Billy Joel's song "James" from *Turnstiles*: "Do what's good for you or you're not good for anybody." I liked auditing but felt I lacked passion. I was soul searching.

Mary Anne and I became man and wife in 1978. I casually mentioned grad school on our wedding night—timing is everything. During the second year of the MBA program at Duke, I interviewed with Deloitte Haskins Sells and was within a day of accepting a job, this time in tax. But the dean came to me and said another faculty member was taking a year's leave of absence and would I like to stay on and teach for a year. One year has turned into three decades.

I always tell students, "Find a job that you would do even if they didn't pay you." For me, that was teaching. I've taught 20,000 students and more than 400 classes. Thirty former students have won CPA medals.

I've been labeled hyperthymestic. I wish! Try compulsive and obsessive, sleep deprived, exceedingly organized. I always wear a suit—that's the Big Eight influence—with braces and French cuffs. I wear certain ties on certain days. I arrange my dollar bills in serial number order, my socks and underwear are alphabetized. I chart everything imaginable.

My biggest professional challenge continues to be balancing the scorecard. Jim Croce sang: "There never seems to be enough time to do the things you want to do once you find them." You can't be perfect, but you try. And I tell students to balance their lives. If you are taking five classes, give each one an hour. I do the same with music. Each day I try to listen to two new songs or one new artist and learn something that might appeal to me or that might excite my students.

I believe CPA firms are landing many, if not most, of the best college business students. A couple superstars will always opt for investment banking or consulting. Better students look to accounting as a challenge because it is a difficult subject to master. If a student wants an accounting career, there is no better place to start than in public accounting. It's stable. You get experience, exposure and flexibility not found in most other entry-level positions.

Teaching awards are merely a byproduct of enjoying what you do. I've been lucky enough to receive two dozen recognitions from three outstanding schools—a veritable embarrassment of riches. I've taught in Europe and Africa—exhilarating. The accomplishments I'm most proud of—a successful marriage and three happy children who tend to my inner landscape. The Beatles summed it up best: "In my life I've loved them all."

—As told to Kim Nilsen